Supreme Court, U.S.
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No. _____

In The
Supreme Court of the United States

HIGHLAND CAPITAL MANAGEMENT, L.P.,
Petitioner,

v.

RBC CAPITAL MARKETS CORPORATION,
LEONARD SCHNEIDER, LESLIE SCHNEIDER,
SCOTT SCHNEIDER AND SUSAN SCHNEIDER,
Respondents.

On Petition for Writ of Certiorari
To the United States Court of Appeals
For the Second Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

Petitioner respectfully submits the following questions for the Court's review:

1. When a federal court is sitting in diversity, should it review a jury verdict according to the sufficiency-of-the-evidence standard of the forum state, as held by the Sixth, Seventh and Eighth Circuits, or according to a federal procedural standard, as held by the remaining U.S. Courts of Appeals?

2. Did the Second Circuit err by reviewing a district court's decision to uphold a jury verdict *de novo*, rather than for abuse of discretion, as required by the Reexamination Clause of the Seventh Amendment and this Court's holding in *Gasperini v. Ctr. for Humanities, Inc.*? Alternatively, did the Second Circuit violate the Reexamination Clause by engaging in appellate review of a jury's factual findings, contrary to the "rules of the common law," as elaborated by Justices Scalia, Rehnquist and Thomas in their dissent in *Gasperini*?

PARTIES TO THE PROCEEDING AND RULE 29.6 STATEMENT

Petitioner is Highland Capital Management, L.P. ("Highland" or "Petitioner"). Highland has no parent company, and there is no publicly-held company that owns more than 10% of Highland.

Petitioner's co-plaintiff in the United States Court for the Southern District of New York, and fellow appellee in the United States Court of Appeals for the Second Circuit, was RBC Capital Markets Corporation (f/k/a RBC Dominion Securities Corporation) ("RBC"), a nominal respondent to this petition. RBC is an indirect, wholly-owned subsidiary of the Royal Bank of Canada, a publicly-held company.

Respondents to the petition are Leonard Schneider, Leslie Schneider, Scott Schneider and Susan Schneider (collectively, "Respondents"). Respondents were Defendants in the United States District Court for the Southern District of New York, and Appellants in the United States Court of Appeals for the Second Circuit.

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PETITION FOR A WRIT OF CERTIORARI

Petitioner respectfully petitions for a writ of certiorari to review a judgment of the United States Court of Appeals for the Second Circuit.

OPINIONS BELOW

Fifteen opinions, including nine that are published, have been issued in the proceeding below, which has involved two separate appeals to the U.S. Court of Appeals for the Second Circuit, and an important state-law question of first impression certified to the New York Court of Appeals.

The decision of the U.S. Court of Appeals for the Second Circuit that is the subject of the instant petition was issued on June 11, 2010, with errata filed on June 22, 2010. It is reported at *Highland Capital Mgmt., L.P. v. Schneider*, 607 F.3d 322 (2d Cir. 2010). (App. 1). This Second Circuit decision reversed an unpublished opinion issued on August 20, 2008, by the U.S. District Court for the Southern District of New York. (App. 55).

Petitioner Highland and Third-Party Defendant and Third-Party Counterclaimant RBC filed separate petitions for rehearing in the Second Circuit. Highland's Petition for Rehearing En Banc was summarily denied on July 29, 2010. (App. 95). RBC's Petition for Panel Rehearing and Rehearing En Banc was summarily denied on August 23, 2010. (App. 97).

Among the opinions rendered in this case, three illustrate the vital importance of the outcome of this proceeding to the national securities markets. The first is the Second Circuit's decision to certify a vital and unsettled question of state law to the New York Court of Appeals, regarding whether the promissory notes at issue in this case should be considered "securities" under New York's Uniform Commercial Code ("U.C.C."). This decision is reported at *Highland Capital Mgmt., L.P. v. Schneider*, 460 F.3d 308 (2d Cir. 2006). (App. 22).

The New York Court of Appeals unanimously accepted the certified question, in a decision reported at *Highland Capital Mgmt., L.P. v. Schneider*, 7 N.Y.3d 836 (N.Y. 2006). (App. 99). The New York Court of Appeals then answered the question in the affirmative, holding that the notes were "securities" within the framework of New York's U.C.C., and that oral agreements to sell them should be enforced, in a decision reported at *Highland Capital Mgmt., L.P. v. Schneider*, 8 N.Y.3d 406 (N.Y. 2007). (App. 101).

Various other opinions have been issued in this case, none of which touch upon the questions presented in this petition. Those other decisions can be found in the electronic case filing system for case number 3:02-cv-01678-H in the U.S. District Court for the Northern District of Texas (docket entry 16) and case number 1:02-cv-08098-PKL-GWG in the U.S. District Court for the Southern District of New York (docket entries 74, 132, and 151).

In addition, two Second Circuit decisions unrelated to the questions presented can be found at *Highland Capital Mgmt., L.P. v. Schneider*, 198 Fed. Appx. 41 (2d Cir. 2006) (ruling on various jurisdictional disputes) and *Highland Capital Mgmt., L.P. v. Schneider*, 485 F.3d 690 (2d Cir. 2007) (holding that diversity jurisdiction was present and remanding to the district court for further proceedings).

JURISDICTION

Highland's Petition for Rehearing En Banc was denied on July 29, 2010. (App. 95). This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

STATUTORY AND CONSTITUTIONAL PROVISIONS

1. The U.S. CONSTITUTION, amend. VII, provides:

> In Suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved, and no fact tried by a jury, shall be otherwise re-examined in any Court of the United States, than according to the rules of the common law.

2. FED. R. CIV. P. 50 provides, in pertinent part:

> **Rule 50. Judgment as a Matter of Law in a Jury Trial; Related Motion for a New Trial; Conditional Ruling**
>
> (a) Judgment as a Matter of Law.
>
> (1) In General.
>
> If a party has been fully heard on an issue during a jury trial and the court finds that a reasonable jury would not have a legally sufficient evidentiary basis to find for the party on that issue, the court may:
>
> (A) resolve the issue against the party; and
>
> (B) grant a motion for judgment as a matter of law against the party on a claim or defense that, under the controlling law, can be maintained or defeated only with a favorable finding on that issue.

(2) Motion.

A motion for judgment as a matter of law may be made at any time before the case is submitted to the jury. The motion must specify the judgment sought and the law and facts that entitle the movant to the judgment.

(b) Renewing the Motion After Trial; Alternative Motion for a New Trial.

If the court does not grant a motion for judgment as a matter of law made under Rule 50(a), the court is considered to have submitted the action to the jury subject to the court's later deciding the legal questions raised by the motion. No later than 28 days after the entry of judgment—or if the motion addresses a jury issue not decided by a verdict, no later than 28 days after the jury was discharged—the movant may file a renewed motion for judgment as a matter of law and may include an alternative or joint request for a new trial under Rule 59. In ruling on the renewed motion, the court may:

(1) allow judgment on the verdict, if the jury returned a verdict;

(2) order a new trial; or

(3) direct the entry of judgment as a matter of law.

STATEMENT OF THE CASE

This case presents two important federal questions: whether federal or state law should govern review of jury verdicts in U.S. Courts under the Seventh Amendment and the *Erie* doctrine, and whether a trial judge's decision to uphold a jury verdict against a challenge to the sufficiency of the evidence should be entitled to appellate deference.

After a three-week trial, a jury in the U.S. District Court for the Southern District of New York found that RBC and Respondents had entered into a binding oral agreement for the sale of certain promissory notes, and awarded RBC and Highland (as third-party beneficiary) approximately 64.5 million in damages, including prejudgment interest. (App. 58).[1] Respondents moved for judgment as a matter of law under FED. R. CIV. P. 50(b), arguing that the evidence was insufficient to support the facts found by the jury.

On August 20, 2008, the District Court issued a 46-page decision denying Respondents' motion in its entirety, finding that the verdict was supported by substantial evidence and should not be overturned. (App. 55-94). Informed by his own firsthand impressions, the trial judge specifically noted that Respondents were impeached repeatedly in front of the jury, in many cases by their own videotaped

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[1] This proceeding was initially filed in Texas state court, removed to federal court under diversity jurisdiction, and then transferred to the Southern District of New York.

deposition testimony. (App. 67). The trial judge identified specific evidence the jury could have relied on in reaching its verdict, including evidence of widespread industry custom, evidence concerning the previous actions of Respondents' agent and longtime securities broker Glen Rauch, and evidence that Respondents had authorized Rauch as their sole representative in the context of final negotiations. (App. 66-67). All of the evidence cited by the trial court could have been relied on by the jury in reaching its verdict, as the trial court concluded. *Id.*

Respondents appealed the trial court's decision to uphold the jury verdict to the U.S. Court of Appeals for the Second Circuit. Settled Second Circuit precedent deems the standard of review for Rule 50(b) motions to be a procedural issue under *Erie*, to be governed by federal procedural law, rather than the law of the forum state.[2] Under the federal procedural standard, the appellate panel reviewed the trial judge's decision to uphold the verdict *de novo*, as though it were sitting in the position of the trial court. (App. 8).

Under this *de novo* standard of review, the panel reversed both the jury and the trial court, holding

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[2] *See, e.g., Katara v. D.E. Jones Commodities, Inc.*, 835 F.2d 966, 970 (2d Cir. 1987). The Second Circuit actually followed forum state law on sufficiency of the evidence in decisions as late as 1975. *Mehra v. Bentz*, 529 F.2d 1137, 1139 (2d Cir. 1975) ("Since this is a question of sufficiency of the evidence, New York law governs the question."), but *Katara* is now the controlling precedent.

that "the trial evidence was insufficient to sustain a finding, by a preponderance of the evidence . . . that RBC could have reasonably believed that Rauch had received authorization from the Schneiders to conclude the trade[.]" (App. 7). The court of appeals failed to ever mention the long list of evidence cited by the district court as supporting the jury's factual findings, but instead, weighed contrary evidence, disagreed with the facts found by the jury, and directed the district court to dismiss the case. (App. 21).

Had New York law governed Respondents' Rule 50(b) motion, by contrast, the court of appeals would have been required to give deference to the trial judge's decision to reject a factual challenge to the jury's verdict. New York courts hold that the decision as to "whether to set aside a jury verdict is within the sound discretion of the trial court. That decision will not be disturbed absent a showing of abuse of that discretion[.]"[3] The New York Court of Appeals has stated that, in reviewing sufficiency of the evidence, an appellate court not only must give proper defe-

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[3] *Sorel v. Iacobucci*, 221 A.D.2d 852, 854 (N.Y. App. Div. 1995) (affirming trial court's refusal to grant judgment n.o.v.); *see also, e.g., Pastore v. Boone*, 127 A.D.2d 872, 873 (N.Y. App. Div. 1987) (upholding denial of a motion for judgment n.o.v., holding that "Plaintiffs' contention that the trial court abused its discretion . . . is without merit."); *Noelle v. Hofflich*, 234 A.D.2d 655, 656 (N.Y. App. Div. 1996) (holding that, while "defendant claims that there was insufficient evidence" to support the verdict, the trial court "did not abuse its discretion in denying defendant's motion.").

rence to the jury, but also may not "impermissibly substitute its version of the facts for those of the trial court."[4]

Had the forum-state abuse of discretion standard, rather than federal *de novo* review, been applied in this case, the Second Circuit would have been precluded from substituting its version of the facts for that of the jury and the trial court, and the jury's verdict and trial court judgment would have been affirmed.

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[4] *Stephenson v. Hotel Emples. & Rest. Emples. Union Local 100 of AFL-CIO*, 2006 N.Y. Slip. Op. 1197, at *4, 6 N.Y.3d 265, 271 (N.Y. 2006); *see also Annunziata v. Colasanti*, 126 A.D.2d 75, 80 (N.Y. App. Div. 1987) (recognizing that "[t]he trial court's ruling setting aside the verdict reflects meticulous attention to the facts and 'an application of that professional judgment gleaned from the Judge's background and experience as a student, practitioner and Judge.'") (citation omitted).

REASONS FOR GRANTING THE WRIT

I. The Court Should Grant Certiorari to Resolve the Longstanding Split in the Federal Circuits Concerning Whether U.S. Courts Should Apply the Forum-State Standard When Reviewing a Post-Verdict Motion for Judgment as a Matter of Law.

The issue of whether federal or state law should govern the review of a Rule 50(b) motion based on the insufficiency of the evidence supporting a jury verdict, when a federal court is sitting in diversity, has deeply divided the U.S. Courts of Appeals. Indeed, in *Dick v. N.Y. Life Ins. Co.*, this Court recognized that the circuits were split on this issue:

> Lurking in this case is the question whether it is proper to apply a state or federal test of sufficiency of the evidence to support a jury verdict where federal jurisdiction is rested on diversity of citizenship. On this question, the lower courts are not in agreement.[5]

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[5] 359 U.S. 437, 444-45 (1959) (noting the direct conflict between the approaches taken by the U.S. Courts of Appeals) (*Comparing Davis Frozen Foods, Inc. v. Norfolk Southern Ry. Co.*, 204 F.2d 839 (4th Cir. 1953), *Reuter v. Eastern Air Lines, Inc.*, 226 F.2d 443 (5th Cir. 1955) *and Diederich v. Am. News. Co.*, 128 F.2d 144 (10th Cir. 1942) (applying a federal sufficiency-of-the-evidence standard), *with Rowe v. Penn. Greyhound Lines, Inc.*, 231 F.2d 922 (2d Cir. 1956), *Cooper v. Brown*, 126 F.2d 874 (3d Cir. 1942) *and Lovas v. Gen. Motors Corp.*, 212 F.2d 805 (6th Cir. 1954) (applying the forum-state standard under *Erie*)). The Second Circuit has since abandoned

In that case, the Court invited certiorari on this "important question" at a later date, noting that:

> [T]he question is not properly here for decision because, in the briefs and arguments *in this Court*, both parties assumed that the [forum-state] standard applied . . . Under these circumstances, we will not reach out to decide this important question particularly where, in the context of this case, the two standards are substantially the same. A decision as to which standard should be applied can well be left to another case where the question is briefed and argued.[6]

That was more than half a century ago, and the U.S. Courts of Appeals remain as divided as ever on this question that implicates both the Reexamination Clause of the Seventh Amendment and the balance of federalism protected by the *Erie* doctrine.

The "important question" recognized by this Court in *Dick* is now squarely and meaningfully presented in this case. The Second Circuit refused to give any deference to the trial court's decision to uphold the jury verdict, as would have been done by the courts of the forum state – and a $64.5 million verdict is hanging in this federal-state balance.

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its deference to state law on this issue. *See supra* note 2.

[6] *Dick*, 359 U.S. at 445 (emphasis added).

As recognized in this Court's decision in *Erie R.R. v. Tompkins*, federal oversight of state judicial action is "an invasion of the authority of the State and, to that extent, a denial of its independence."[7] Federal judges were prohibited from substituting their own judgment for that of their state colleagues on substantive issues of state law because "no clause in the Constitution purports to confer such a power upon the federal courts."[8]

In reliance on the *Erie* doctrine, three U.S. Courts of Appeals – the Sixth, Seventh and Eighth Circuits – have held that the review of sufficiency of the evidence in a Rule 50(b) motion involves a substantive issue of state law, and that to further "the twin aims of the Erie rule: discouragement of forum-shopping and avoidance of inequitable administration of the laws,"[9] federal courts should apply the same standard as would be applied by the forum state.[10]

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[7] 304 U.S. 64, 79 (1938).

[8] *Id.* at 78.

[9] *Chambers v. NASCO, Inc.*, 501 U.S. 32, 52 (1991) (citing *Hanna v. Plumer*, 380 U.S. 460, 468 (1965)).

[10] *See, e.g., K & T Enters. v. Zurich Ins. Co.*, 97 F.3d 171, 176 (6th Cir. 1996) ("[W]hen sitting in diversity, we review denial of a Rule 50 motion using the same standards applicable under the law of the forum state. . . . We hold that in diversity cases, a state law standard of review is applicable only when a Rule 50 challenge is mounted to the sufficiency of the evidence supporting a jury's findings.") (citations omitted); *Europlast, Ltd. v. Oak Switch Sys.*, 10 F.3d 1266, 1270 (7th Cir. 1993) (stating that in a diversity case, "we apply the forum state's

By contrast, the Second Circuit and eight other circuits view the issue as procedural and apply a federal standard of review under Rule 50(b).[11] Several circuits have even held that, where federal and state standards for review of sufficiency of the

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standard of review for granting a [Rule 50(b)] JNOV motion" and applying the Illinois standard) (citations omitted); *Carper v. State Farm Mut. Ins. Co.*, 758 F.2d 337, 340 (8th Cir. 1985) (applying the forum-state standard to a Rule 50(a) motion for a directed verdict, holding that, "[a]pplying the [Iowa] standards, we cannot say that the jury verdict in favor of plaintiffs was unsupported by sufficient evidence."). *But see Schneider v. Chrysler Motors Corp.*, 401 F.2d 549, 554 (8th Cir. 1968) (stating that the approach favored in the circuit is to avoid deciding the issue when the federal and state standards are similar, in part because of the lack of guidance on the issue by this Court since *Dick*) (citing *Dick*, 359 U.S. at 444-45).

[11] *See, e.g., Novak v. Capital Mgmt. & Dev. Corp.*, 570 F.3d 305, 311 (D.C. Cir. 2009) (citations omitted); *Mandel v. Boston Phoenix, Inc.*, 456 F.3d 198, 207-08 (1st Cir. 2006) (citations omitted); *Katara*, 835 F.2d at 970; *Feit v. Great W. Life & Annuity Ins. Co.*, 271 Fed. Appx. 246, 251 (3d Cir. 2008) (citations omitted); *Allen v. Zurich Ins. Co.*, 667 F.2d 1162, 1164-65 (4th Cir. 1982) (citing *Davis Frozen Foods*, 204 F.2d 839, 842 (4th Cir. 1953) ("[T]hat the question is one of federal and not of state practice, is too well settled to admit of argument . . . .")); *Brown v. Ford Motor Co.*, 479 F.2d 521, 523 n.3 (5th Cir. 1973); *White v. Ford Motor Co.*, 312 F.3d 998, 1010 (9th Cir. 2002); *Chicago, Rock Island & Pac. Ry. Co. v. Howell*, 401 F.2d 752, 754 (10th Cir. 1968) (holding, under the closely-related Rule 50(a) standard for a directed verdict, that "[w]hile the competency of the circumstantial evidence to prove the plaintiff's case is controlled by Oklahoma law, its sufficiency to go to the jury is controlled by federal common law."); *Elliot v. Turner Constr. Co.*, 381 F.3d 995, 1005 (10th Cir. 2004) (applying federal standard to Rule 50(b) motion in diversity); *Hopkins v. BP Oil*, 81 F.3d 1070, 1074 (11th Cir. 1996).

evidence conflict, applying the state standard under *Erie* would create a conflict with the Seventh Amendment.[12] However, as this Court's holding in *Gasperini v. Ctr. For Humanities, Inc.* suggests, the text of the Seventh Amendment, which requires that review of jury verdicts be "according to the rules of the common law," does not automatically support these circuits' conclusions that application of state law is inappropriate.[13]

Indeed, as this case illustrates, the *Erie* doctrine's purpose of removing incentives for forum-shopping between state and federal court is particularly appropriate in the Rule 50(b) context. Had the litigation below proceeded in New York state court, the state appellate court would have given deference to the trial judge's decision to uphold a jury verdict,[14] and accordingly, the trial court's decision to uphold Petitioner and RBC's $64.5 million verdict would have been affirmed.

Presuming that the vast majority of Rule 50(b) motions, for a judgment contrary to the jury's verdict, are denied by trial judges, obtaining *de novo* review of a trial court's determination – a second chance to

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[12] *Diederich*, 128 F.2d at 146; *Reuter*, 226 F.2d at 445.

[13] 518 U.S. 415 (1996). Indeed, this Court's central holding in *Gasperini* was that "New York's law controlling compensation awards for excessiveness or inadequacy can be given effect, without detriment to the Seventh Amendment, if . . . appellate control of the trial court's ruling [is] limited to review for 'abuse of discretion.'" *Id.* at 419.

[14] *See supra* note 3.

question the jury's judgment – provides a powerful incentive for forum shopping. The rationale behind the *Erie* doctrine, therefore, counsels that federal judges should apply the same standard under Rule 50(b) as their forum-state colleagues, including, where required by the forum state, lowering the evidentiary bar when reviewing a verdict that was upheld by the trial court.

The application of state law in the Sixth, Seventh and Eighth Circuits is further supported by this Court's holding in *Gasperini*. There, this Court held that federal courts sitting in diversity must apply state-law standards in reviewing jury awards if state law departs from the federal standard for judging excessiveness.[15] There is no reason why forum-state law should govern review of the size of a jury verdict, but not the review of whether the verdict as a whole should be upheld by the court. The majority in *Gasperini* specifically noted that:

> Where a federal court is exercising jurisdiction solely because of the diversity of citizenship of the parties, *the outcome of the litigation in the federal court should be substantially the same, so far as legal rules determine the outcome of litigation*, as it would be if tried in a state court.[16]

And, as the Second Circuit observed in *Evans v. S. J. Groves & Sons Co.*:

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[15] 518 U.S. at 431.

[16] *Id.* at 428 (emphasis added).

> The present case well illustrates the conflicting pulls on the issue: The state law can be regarded on the one hand as a rule relating to the distribution of power between court and jury and thus as not binding on a federal court under the Seventh Amendment even in a diversity case . . . or, on the other, as a substantive rule[.][17]

The courts of appeals have, accordingly, remained divided on this delicate question.

Such a broad and enduring circuit conflict calls for intervention and remedy by this Court – as this Court has already recognized, inviting certiorari to resolve this "important question."[18]

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[17] 315 F.2d 335, 342 n.2 (2d Cir. 1963).

[18] *Dick*, 359 U.S. at 444-45.

II. The Court Should Grant Certiorari to Determine Whether the Seventh Amendment Limits Federal Appellate Review of Trial Court Judgments Under Rule 50(B), as Suggested by Both the Majority and the Dissenting Justices in *Gasperini v. Ctr. For Humanities, Inc.*

A. The Seventh Amendment clearly limits appellate review of jury verdicts.

Assuming that a federal standard applies to the review of a trial court's rejection of a Rule 50(b) challenge to a jury's factual findings, the critical issue for the litigants in this proceeding is whether a judgment, supported by a unanimous jury and the trial court, can be reviewed *de novo* at the appellate level. On this issue, the federal circuits and this Court have likewise failed, thus far, to speak with one voice.

Where a jury has made its factual findings and the trial judge has confirmed that such findings were amply supported by the evidence, as in the proceeding below, *de novo* review by a court of appeals violates the Seventh Amendment.

The Reexamination Clause of the Seventh Amendment guarantees that "no fact tried by a jury, shall be otherwise reexamined in any Court of the United States, than according to the rules of the common law."[19] Despite this mandate, the panel in

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[19] U.S. CONST., amend. VII.

this case evaluated the facts, weighed the evidence, and made credibility determinations contrary to the findings of the jury and the trial judge who had heard the evidence and observed the witnesses firsthand. (App. 8-19).

The Reexamination Clause was adopted to forbid precisely this kind of interference by the appellate courts with a jury's findings of fact, and to assuage litigant's fears that jury verdicts would be overturned capriciously by appellate courts.[20] Indeed, Justices Scalia, Rehnquist and Thomas, in their dissent in *Gasperini v. Ctr. for Humanities, Inc.*, pointed out that "appellate review of district-court refusals to set aside jury awards as against the weight of the evidence was 'once deemed inconsonant with the Seventh Amendment's Reexamination Clause[.]'"[21] Since the Seventh Amendment prohibits review other than according to the "rules of the common law," the

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[20] *See, e.g., United States v. Wonson*, No. 16,750, 1 Gall. 5, 28 F. Cas. 745, 750 (U.S. Cir. Ct. Mass. 1812) (Story, J.) (the "scope and object" of the Seventh Amendment addressed "apprehensions entertained of new trials by the appellate courts"); *see also* Tribe, Laurence, *Am. Constitutional Law*, § 3-32, *The Seventh Amendment Right to Trial by Jury as a Limit on Federal Judicial Power*, at 624 (stating that the history of the Reexamination Clause "reveals that it was adopted principally to protect jury verdicts from after-the-fact judicial interference, especially by appellate courts"); *Gasperini*, 518 U.S. at 452 (Scalia, J., dissenting) (stating that the Seventh Amendment "quite plainly barred reviewing courts from entertaining claims that the jury's verdict was contrary to the evidence.").

[21] 518 U.S. at 458 (quoting the majority, 518 U.S. at 434).

dissent in *Gasperini* outlined a persuasive argument that the more recent development of appellate reexamination of jury verdicts is contrary to our Constitution.

And Justices Scalia, Rehnquist and Thomas are not alone in this conclusion. The Eleventh Circuit has likewise recognized that "[a]t common law, no review of jury verdicts was permitted except upon writs of error, which were limited to questions of law. The Seventh Amendment incorporated this principle, forbidding any reexamination of a jury's determination of the facts."[22] Accordingly, in some contexts, the Eleventh Circuit follows the same standard as the eighteenth-century writ of error – affording absolute deference to a jury's factual findings.[23] Needless to say, if the proceeding below had arisen in the Eleventh Circuit, and if the Eleventh Circuit chose to extend the protection afforded by this Seventh Amendment holding to the Rule 50(b) context,[24] Petitioner would not, and indeed could not, have seen its verdict overturned.

The Tenth Circuit, meanwhile, has at times given deference to a trial court's ruling on sufficiency of the

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[22] *Johansen v. Combustion Eng'g, Inc.*, 170 F.3d 1320, 1330 (11th Cir. 1999) (citing *Gasperini*, 518 U.S. at 452).

[23] *Id.*

[24] *See, e.g., Cleveland v. Home Shopping Network, Inc.*, 369 F.3d 1189, 1193 (11th Cir. 2004) (reviewing a jury's factual findings in the context of a Rule 50(b) motion, without addressing the circuit's contrary holding in *Johansen*).

evidence, similarly to the state courts of New York. It has noted that "[i]t is . . . the function of the trial court to analyze the evidence and appraise its sufficiency in the first instance[,]" and that "we should not superimpose our judgment on that of the trial court unless we can say . . . that [its] judgment . . . was clearly wrong."[25] The circuit has not, however, been consistent in following this approach.[26]

The Tenth and Eleventh Circuit holdings cited above, embodying as they do, respectively, deference to the trial judge and to the jury's role as fact-finder, would have accorded with majority opinion at the time the Seventh Amendment was drafted.[27] Deference to juries in colonial times was more robust than it is today. In fact, some historical commentators have suggested that the absence of the right to a jury trial in the Constitution was the driving force behind the enactment of the Bill of

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[25] *High Voltage Eng'g Corp. v. Pierce*, 359 F.2d 33, 38 (10th Cir. 1966) (noting that this deferential standard applies to any trial court determination in which "[i]nsufficiency of the evidence is . . . one of the . . . grounds for directing a verdict, granting a judgment n.o.v. or a new trial[.]").

[26] *See, e.g., M.D. Mark, Inc. v. Kerr-McGee Corp.*, 565 F.3d 753, 761 (10th Cir. 2009) (reviewing *de novo* a district court's denial of a Rule 50(b) motion).

[27] *See Gasperini*, 518 U.S. at 457 (Scalia, J., dissenting) (recognizing that "our prior cases were correct that, at common law, 'reexamination' of the facts found by a jury could be undertaken only by the trial court, and that appellate review was restricted to writ of error which could challenge the judgment only upon matters of law.").

Rights.[28] The Anti-Federalists, in particular, believed strongly in the fact-finding role of juries and the adoption of the Seventh Amendment in 1791 reflected the importance attributed to this issue.[29]

This Court's own cases have long recognized the deference due to a jury's findings of fact. As this Court stated in *Lavender v. Kurn,* with regard to a challenge to the sufficiency of the evidence in support of a jury verdict:

> The jury having made [the crucial inference], the respondents were not free to relitigate the factual dispute in a reviewing court. Under these circumstances it would be an undue invasion of the jury's historic function for an appellate court to weigh the conflicting evidence, judge the credibility of witnesses and arrive at a conclusion opposite from the one reached by the jury.[30]

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[28] *See, e.g.*, Tribe, *supra* note 20, § 3-32, at 616-17; *see also* Bassett, Debra Lyn, *"I Lost At Trial—In The Court Of Appeals!": The Expanding Power of The Federal Appellate Courts to Reexamine Facts*, 38 Houston L. Rev. 1129, 1131 (2001) ("One of the primary motivations behind the Declaration of Independence was the Crown's attempt to encroach upon the right to trial by jury.").

[29] For example, Section 22 of the Judiciary Act of 1789 states that "there shall be no reversal in either [U.S. Circuit or Supreme] court on such writ of error . . . for any error in fact." These restrictions were carried forward in all U.S. judicial codes promulgated until 1948. Tribe, *supra* note 20, § 3-32, at 625.

[30] 327 U.S. 645, 652-53 (1946).

And, regarding the deference to be afforded a trial judge, this Court in *Gasperini* held that while appellate review for abuse of discretion is appropriate in reviewing *excessiveness* of jury verdicts, such limited review is "reconcilable with the Seventh Amendment as a control necessary and proper to the fair administration of justice."[31] The majority further reasoned that an abuse of discretion standard is appropriate because:

> [t]rial judges have the 'unique opportunity to consider the evidence in the living courtroom context,' while appellate judges see only the 'cold paper record.' . . . If [courts of appeals] reverse, it must be because of an abuse of discretion . . . . The very nature of the problem counsels restraint . . . . [Appellate courts] must give the benefit of every doubt to the judgment of the trial judge.[32]

Justice Ginsburg's rationale for the application of an abuse-of-discretion standard, articulated in the context of a review of punitive damages, is equally applicable to Rule 50(b):

> Apart from 'Seventh Amendment constraints,' an abuse-of-discretion standard also makes sense for practical reasons . . . district courts have an undeniably superior

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[31] 518 U.S. at 435.

[32] *Id.* at 438-39 (citing *Dagnello v. Long Island R.R. Co.*, 289 F.2d 797, 806 (2d Cir. 1961)).

> vantage over courts of appeals . . . district courts view the evidence not on a 'cold paper record,' but 'in the living courtroom context.' They can assess from the best seats the vital matter of witness credibility.[33]

Indeed, this rationale, that the Seventh Amendment does not allow a second, *de novo* review of a jury's factual findings, applies with even greater force to the case of a Rule 50(b) motion, where the entire jury verdict is called into question.

This reasoning, together with the mandates of the Seventh Amendment, requires a limitation of appellate review to whether the trial court abused its discretion in the context of a denial of judgment as a matter of law under Rule 50(b). Like the *Erie* issue of the applicability of state law, the issue of the appropriate *federal* standard of review has divided the circuits. The Court should take this opportunity to expressly clarify the proper standard to be applied, be it *de novo* review, review for abuse of discretion, or writ-of-error review that—as in the days when the Seventh Amendment was enacted—leaves factual findings to the jury.

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[33] *Cooper Indus. v. Leatherman Tool Group*, 532 U.S. 424, 449 (2001) (Ginsburg, J., dissenting) (citing *Gasperini*, 518 U.S. at 438).

B. This case is particularly appropriate for determining the correct standard of review because, under an abuse of discretion standard, the Second Circuit could not have reversed the trial court.

The Second Circuit reversed the trial court below on a discrete factual issue: whether there was sufficient evidence that longtime securities broker Glen Rauch, Respondents' agent, had actual or apparent authority to make an oral securities trade. (App. 8-19).

In sustaining the jury's verdict, the District Court listed the following evidence that the jury could have relied on, specifically to make a factual finding of actual or apparent authority:

1. "[T]he Letter Agreement" governing Rauch's authority, which had been extensively negotiated by Respondents, "did not exclude Rauch from having the authority to bind defendants." (App. 66).

2. "[I]t was industry custom and practice for brokers, like Rauch, to routinely enter into binding agreements on behalf of their clients." *Id.*

3. "Rauch, who was the defendants' broker for a number of years, [had] considered bids, including 'firm' offers . . . on behalf of defendants in dealing with RBC." *Id.*[34]

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[34] On this point, the District Court specifically cited testimony at trial. (App. 66) (citing Trial Tr. at 521:5-19, 525:4-7).

4. "[T]here was evidence that defendants directed that RBC communicate with defendants only through Rauch." *Id.*[35]

5. "'Testimony from [Respondents] and Rauch indicated that Rauch routinely communicated with Leonard [Schneider] regarding trades for [his children] Leslie, Susan, and Scott [Schneider].'" (App. 66-67).

6. "Regarding the Letter Agreement, Rauch stated that Leonard [Schneider] authorized him to sign on behalf of Leonard, Leslie, Susan, and Scott." (App. 67).[36]

7. "Rauch also stated that Leonard [Schneider] 'usually spoke for his children.'" *Id.*[37]

8. "[A]ttorney James Alterbaum represented all defendants and approved of the Letter Agreement." *Id.*

9. "[P]laintiffs introduced Leonard's deposition testimony to impeach his testimony at trial on this issue." *Id.*

10. "Despite defendants' testimony in support of their position, their credibility was challenged more

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[35] On this point, the District Court cited an exhibit introduced by the Plaintiffs at trial. (App. 66) (citing Pls.' Ex. 50).

[36] On this point, the District Court specifically cited testimony at trial. (App. 67) (citing Trial Tr. at 491:10).

[37] On this point, the District Court specifically cited testimony at trial. (App. 67) (citing Trial Tr. at 491:10).

> than once during the course of the trial. Such challenges included impeachment through the introduction of prior deposition testimony, as well as contradictory evidence presented by plaintiffs." (App. 60).

The trial judge held that all of this evidence supported the jury's findings. (App. 66-67).

The appellate panel, in reviewing the trial court's decision, did not dispute the existence of *any* of the above evidence. In fact, it did not so much as address the conclusions that could be drawn from the evidence listed by the district court. Instead, relying on two recorded phone calls in which Rauch merely expressed hesitancy, the panel overruled the jury's findings. (App. 12-17). Had the appellate panel reviewed the trial court's decision under an abuse-of-discretion standard, however, it would have deferred to the trial court's conclusions and affirmed its decision.

But, in re-weighing the contrary evidence, the panel did not so much as consider the possibility that Rauch's hesitancy in the two recorded calls was due, not to his lack of authority, but instead, for instance, to a courtesy to Respondents, or a stalling tactic in a heated negotiation. (App. 12-17). Both are reasonable inferences that could have been made by the jury, and which support the trial court's decision to uphold the verdict.

Indeed, an agent's decision to contact their principal prior to concluding a deal would be sound

practice, *regardless* of whether the agent was authorized to conclude a deal on their own when time was of the essence. The panel seems not to have considered this possibility, based on its erroneous belief that inferences favorable to the movant could be granted only on "disputed" evidence.[38]

Because it failed to address the list of evidence set forth by the trial court, or the factual inferences supporting the trial court's decision, the Second Circuit's decision below would not survive application of an abuse of discretion standard that recognizes the superior position of a trial judge in making a Rule 50(b) determination.

The Reexamination Clause of the Seventh Amendment establishes a delicate separation of powers between trial judge, jury and appellate court. Because the Second Circuit's decision below has violated that balance, this Court should grant

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[38] The key to understanding the Second Circuit's decision may lie in its statement that Rule 50(b) review involved "taking all ambiguous or disputed evidence in the light most favorable to the Appellees, but construing it in light of the extensive undisputed evidence[.]" (App. 20). In reality, of course, *both* disputed and undisputed pieces of evidence may be interpreted in various manners. Even though the content of Rauch's recorded calls was itself undisputed, the *import* of his statements – whether Rauch really could not conclude a deal without Respondents' prior approval, or he was simply stalling – was properly decided by the jury, particularly in light of the fact that Rauch's testimony had been impeached. (App 60). Indeed, in refusing to draw inferences favorable to Petitioner even from undisputed evidence, the Second Circuit panel incorrectly applied the *de novo* standard of review.

certiorari and reverse, applying the appropriate standard.

III. The Court Should Grant Certiorari in this Case Because the Subject Matter of the Proceeding Below Involves a Question of Extreme Importance for the National Securities Markets in New York.

Granting certiorari in this case, to address the deep division in the federal circuits arising under the Seventh Amendment and the *Erie* doctrine, and to articulate the correct standard if federal law governs Rule 50(b) motions, is triply justified by the national importance of the substantive question at issue in the case.

Petitioner and RBC's dispute with Respondents centers on whether an oral agreement in which an agent agrees to sell securities is enforceable against the principal. When the New York Court of Appeals was called upon, in the proceeding below, to decide whether such promissory notes qualified as "securities" and whether an oral agreement to sell them could, therefore, be enforceable, it answered in the affirmative. (App. 112). As recognized below by both the Second Circuit and the New York Court of Appeals, the question is one of great importance to the "free flow of capital" in New York and, therefore,

an issue of national importance, since "New York [is] the financial capital" of the nation.[39]

In reversing the jury's verdict, the Second Circuit found that extensive evidence that Rauch, Respondents' agent, entered into an unrecorded securities trade was insufficient to hold Respondents to the agreement. (App. 12-17). This holding, while premised on the facts of the proceeding below, would *de facto* be applicable to numerous similar oral agreements entered into by agents, and would create a significant risk of uncertainty regarding the finality of oral trades.

The sale of securities under New York law is governed by Section 8 of the New York Uniform Commercial Code. Section 8-113(a) of the U.C.C. expressly exempts the sale of most securities, such as

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[39] The Second Circuit noted, in certifying the question of whether the promissory notes should be considered "securities," that the uncertainty stemming from the issue "create[s] problems in the marketplace. Understanding the notes to be 'securities,' brokers and other industry professionals are not structuring their deals differently to accommodate the more narrow U.C.C. definition. As a result, the rights and duties of buyers and sellers in the marketplace differ depending upon what sort of financial asset they are trading, even when these assets are being sold in the same manner, by the same clients, through the same brokers. Imposing such uncertainty upon the financial community risks deterring the trading of promissory notes in financial markets, thereby restricting the free flow of capital. This is an undesirable result anywhere, but particularly here in New York, the financial capital." (App. 46-47). The New York Court of Appeals unanimously accepted the certified question, and answered in the affirmative. (App. 100, 112).

the notes at issue, from the Statute of Frauds that would otherwise require such agreements to be in writing to be enforceable.[40] Specifically, Section 8-113 provides that, "[e]xcept as provided in subsection (b), a contract or modification of a contract for the sale or purchase of a security is enforceable *whether or not* there is a writing signed or record authenticated by a party against whom enforcement is sought, even if the contract or modification is not capable of performance within one year of its making."[41]

There is no support under New York law for the apparent insistence, by the second panel of the Second Circuit to review the proceedings below,[42] that a counterparty must obtain specific assurances that an agent's principal has agreed to a deal, when it is clear from the parties' course of dealings that the broker is the authorized agent of the principal. The second panel's opinion would permit any principal to abandon any trades it subsequently determined were not in its favor, in the absence of such assurances. This added requirement undermines the certainty of securities trades and is inconsistent with New York law, which requires a counterparty to inquire as to

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[40] N.Y. U.C.C. § 8-113(a).

[41] *Id.* (emphasis added).

[42] The proceeding below was appealed twice to the Second Circuit. *See* Opinions Below, *supra*, at 1. Because of this fact, the panel that reviewed the jury's verdict was different from the panel that dealt with the evidence of Respondents' liability at the summary judgment stage.

the scope of an agent's authority only where "the facts and circumstances are such as to put him on inquiry, the transaction is extraordinary, or the novelty of the transaction alerts the third party to the danger of fraud."[43]

The jury's verdict in the Southern District of New York, holding Respondents to account under their agent's oral agreement, is nothing but the logical result of the New York Court of Appeals' holding that promissory notes are "securities" and can, therefore, be traded orally. (App. 112). The Court of Appeals unanimously accepted certification of this question, precisely in order to clear up any uncertainty concerning oral transactions in promissory notes. (App. 100). The second panel's decision to overrule both trial judge and jury has again muddied the waters by making it unclear under New York law whether a principal may be bound by the word of their agent.

As recognized by New York courts, the U.C.C. reflects the New York legislature's efforts to conform the law of New York with the real-world mechanics of securities trading – *i.e.*, the enforceability of oral agreements as to "size" and "price" of securities – helping ensure the seamless functioning of the

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[43] *Herbert Constr. Co. v. Cont'l Ins. Co.*, 931 F.2d 989, 995-96 (2d Cir. 1991) (internal quotations marks and citations omitted); *see also Am. Nat'l Fire Ins. Co. v. Kenealy*, 72 F.3d 264, 269 (2d Cir. 1995); *Marathon Enters., Inc. v. Schroter GMBH & Co.*, 95 Fed. Appx. 364, 367 (2d Cir. 2004).

capital markets.[44] The importance of those markets to the national economy needs no further evidence, in light of the nation's recent history.

CONCLUSION

For the reasons set forth above, Petitioner respectfully requests that the Court grant certiorari on the questions presented.

Respectfully submitted,

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[44] *See Tradewinds Fin. Corp. v. Repco Secs., Inc.*, 5 A.D.3d 229, 229-30 (1st Dep't 2004).

Highland Capital Management LP, Plaintiff-Appellee, BC Dominion Securities Corp., Third-Party-Defendant-Counter-Claimant-Appellee,

v.

Leonard Schneider, Leslie Schneider, Scott Schneider, Susan Schneider, Defendants-Third-Party-Plaintiffs-Counter-Defendants-Appellants, Jenkins & Gilchrist Parker Chapin LLP, Defendant.

Docket No. 08-4630-cv

UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

607 F.3d 322; 2010 U.S. App. LEXIS 12735

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JUDGES: Before: LEVAL and RAGGI, Circuit Judges, and COTE, District Judge.*

OPINION BY: LEVAL

OPINION

LEVAL, *Circuit Judge*:

Defendants Leonard Schneider ("Schneider") and his children, Leslie, Scott, and Susan Schneider (collectively, "Defendants" or "the Schneiders") appeal from the judgment of the United States District Court for the Southern District of New York (Leisure, *J.*), which held them liable for damages to Plaintiff Highland Capital Management LP ("Highland") and Counter-Claimant RBC Dominion Securities Corp. ("RBC") (jointly, "Appellees"), pursuant to a jury verdict after trial, in the amount of approximately $ 40 million for breach of an alleged contract for the sale of promissory notes. Highland claimed to be the third-party beneficiary of an alleged contract by which the Schneiders, acting through an agent, Glen Rauch Securities ("GRS"), agreed to sell promissory notes of the McNaughton Apparel Group, Inc. ("McNaughton") at fifty-one percent of their face value to RBC. Appellees contend that, after several weeks of negotiation between Glen Rauch of GRS,

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* The Honorable Denise Cote of the United States District Court for the Southern District of New York, sitting by designation.

acting for the Schneiders, and RBC, they concluded the alleged contract in an unrecorded telephone conversation on March 14, 2001. The Schneiders argue, among other contentions, that there could be no contract because their agent, GRS, had neither actual nor apparent authority to make the alleged contract on their behalf. We agree with the Schneiders that the evidence cannot support a finding that Rauch had either actual or apparent authority to make the contract or even that he expressed agreement to sell the notes. We therefore remand to the district court with instructions to set aside the verdict and enter judgment in favor of the Schneiders.

BACKGROUND

The evidence at trial, seen in the light most favorable to Appellees, showed the following. The Schneiders owned and operated two apparel businesses, which they sold to McNaughton in April 1998. In connection with this sale, they received McNaughton's promissory notes for $ 69 million. The Schneiders later became interested in selling the notes. To assist them in making the sale, they engaged GRS, which acted through its principal, Glen Rauch. Rauch contacted RBC as a potential purchaser. Before beginning negotiations in earnest over the sale of the notes, RBC and Rauch executed a Letter Agreement outlining the terms of the negotiations. The agreement stated:

> Reference is made to certain promissory notes [of McNaughton] . . . held by [the Schneiders].

> [RBC] understand[s] that Glen Rauch Securities, Inc. ("GRS") represents [the Schneiders] in the possible resale of some or all of the Notes. . . .
>
> . . .
>
> We both understand that the consummation of any transaction remains in the sole discretion and satisfaction of the [Schneiders] and [RBC], including without limitation with respect to price.

Pl.'s Ex. 20. Rauch instructed RBC that its communications concerning the proposed transaction should go through him and that it should not communicate directly with the Schneiders.

RBC intended to purchase the notes incurring only minimal risk by, prior to purchase, arranging to resell them to a third party at a markup over its own purchase price. During the course of its negotiations with the Schneiders, RBC received bids for the notes from Highland and another firm.

Most of the negotiations for RBC's purchase of the notes from the Schneiders were conducted by telephone, between Kenneth Ambrecht of RBC and Rauch. Because of doubts about McNaughton's solvency, the negotiations discussed prices representing a 35-60% discount from the face value of the notes. The content of the negotiations is largely undisputed, because RBC routinely recorded all telephone calls through its trading desk. The recordings of the conversations between Rauch and RBC show that, in

accordance with the Letter Agreement, Rauch always sought authorization from the Schneiders before making any firm proposal to RBC and always made clear to RBC that any proposed terms required the Schneiders' approval. For example, on January 31, 2001, Ambrecht asked Rauch, "[I]s there any way you can get a firm [offer]?" J.A. 693. Rauch responded, "I'll tell [the Schneiders] to make you an offer." *Id.* On February 12, after consulting with the Schneiders, Rauch responded to Ambrecht with a "firm" offer at fifty-nine percent of face value. J.A. 708. After RBC rejected this price, Rauch told Ambrecht on February 26 he was "85 percent sure" he could "trade the whole piece at 54 [percent of face value]," explaining his uncertainty by noting, "I mean you know, dealing with individuals that are [laughter]." J.A. 711. Later that day, Rauch told Ambrecht that the Schneiders would "probably" agree to a price of fifty-three for the entire block of their notes. J.A. 719. However, Rauch also told Ambrecht that he had recently spoken with Leonard Schneider and it was Schneider's position that at "anything less than [fifty-four Schneider was] gonna hold on to 'em for a while." *Id.*

The negotiations continued in similar fashion into March. On March 12, Ambrecht made an offer at 50.5. Rauch replied, "I'm going to have to reflect back because the last thing I told [the Schneiders] was fifty-one is firm and now I've got to go back and tell them fifty and a half." J.A. 769. When the Schneiders rejected this price, Ambrecht said he would attempt to raise the price to fifty-one, but Rauch told him,

"No, at this point, now, they're not going to do anything for a day and a half." J.A. 774. Yet on March 13 Rauch still thought "they'll probably trade them all at fifty-one." J.A. 802. He told Ambrecht, "You know we're not haggling we're done at fifty-one if it gets done and it will probably be tomorrow morning." J.A. 804.

Unbeknownst to Rauch and RBC, however, the Schneiders had received information from McNaughton that significantly altered prospects for payment of the notes, and hence their value. On March 9, McNaughton informed the Schneiders' attorneys that it had received an inquiry from another company about the purchase of McNaughton. The attorneys contacted Schneider the same day, and advised him that "something good was happening with [McNaughton]." Trial Tr. 837. On March 13, the Schneiders met with the attorneys, who "talked about the possibility . . . of a merger or an acquisition of McNaughton . . . and that if that happened, that the notes would . . . be paid 100 cents on the dollar." Trial Tr. 895.

This case turns on the events of the following day, March 14. Rauch and Ambrecht had two recorded phone calls that day. Approximately ten minutes after the second recorded call, RBC called Rauch back, in an effort to "pin[ ] Mr. Rauch down." Trial Tr. 375. This call, unlike the others, was not recorded, because it was made from the office of Max Holmes, Co-Head of RBC's High-Yield Group, and not from RBC's trading desk. Appellees contend that during the unrecorded call, RBC and Rauch, on behalf

of the Schneiders, formed a contract for the sale of the notes at fifty-one. We discuss in detail below the evidence of the content of all three March 14 phone calls. As explained below, the trial evidence was insufficient to sustain a finding, by a preponderance of the evidence, that Rauch had received authorization from the Schneiders to make the sale, that RBC could have reasonably believed that Rauch had received authorization from the Schneiders to conclude the trade, or that, under the circumstances, RBC could have reasonably interpreted Rauch's words as expressing agreement to sell the notes at fifty-one.

Rauch learned soon after the unrecorded call that the Schneiders had lost interest in selling the notes. On the night of March 14, the Schneiders' attorney, Jim Alterbaum, left a message for Rauch telling him that Alterbaum was "not sure [the] Schneiders want [Rauch] to proceed with phone calls" to RBC and advising Rauch not to "spin his wheel." Pl.'s Ex. 26. The Schneiders then told Rauch they had decided to put on hold any sale of the notes. On March 20, Rauch told Ambrecht, "nothing is going to happen with the bonds probably for five weeks." J.A. 907.

The Schneiders never sold the notes. On April 16, 2001, Jones Apparel Group announced that it would buy McNaughton. On June 19, the notes were paid in full.

This litigation followed, involving claims by RBC and Highland that, during the unrecorded March 14

call between Rauch and RBC's representatives, the Schneiders contracted to sell their McNaughton notes at fifty-one and that they subsequently breached the contract. The Schneiders denied that Rauch had actual authority to make such a sale, that apparent authority for the transaction was ever communicated to the buyers, or that Rauch ever agreed to sell the notes. After a tortuous pretrial history, which we do not recite because it has no pertinence to the issues on this appeal, the case proceeded to trial. The jury found against the Schneiders and awarded damages for breach of contract totaling approximately $ 40 million to RBC and Highland. The district court denied the Schneiders' motion for judgment as a matter of law ("JMOL") or a new trial, and this appeal followed.

DISCUSSION

Under Rule 50 of the Federal Rules of Civil Procedure, a district court may grant JMOL against a party if "a reasonable jury would not have a legally sufficient evidentiary basis to find for the party." Fed. R. Civ. P. 50(a). We review a denial of JMOL de novo. *S.E.C. v. DiBella*, 587 F.3d 553, 563 (2d Cir. 2009). In undertaking this review, "we view the evidence in the light most favorable to the party against which the motion was made." *Metromedia Co. v. Fugazy*, 983 F.2d 350, 361 (2d Cir. 1992), *abrogated on other grounds as noted in Yung v. Lee*, 432 F.3d 142, 147 (2d Cir. 2005). JMOL is properly granted "only when, drawing all reasonable inferences regarding

the weight of the evidence and the credibility of witnesses in favor of the non-movant, a reasonable jury could only have found for the movant." *Kim v. Hurston*, 182 F.3d 113, 117 (2d Cir. 1999) (internal quotation marks and alterations omitted).

Appellees' claims rely on a contract between the Schneiders and RBC, which they contend Rauch agreed to on the Schneiders' behalf during the unrecorded phone call of March 14. The evidence would support a finding of such a contract only if it allowed for a reasonable finding that Rauch had actual authority to make the agreement or if RBC relied on his apparent authority to do so. *Merrill Lynch Interfunding, Inc. v. Argenti*, 155 F.3d 113, 122 (2d Cir. 1998) ("[A]n agent must have authority, whether apparent, actual or implied, to bind his principal."). We conclude that the record contains insufficient evidence to support either finding, or indeed even a finding that Rauch purported to enter a contract without authorization.

I. Actual Authority

Under New York law, an agent has actual authority if the principal has granted the agent the power to enter into contracts on the principal's behalf, subject to whatever limitations the principal places on this power, either explicitly or implicitly. *Ford v. Unity Hosp.*, 32 N.Y.2d 464, 299 N.E.2d 659, 664, 346 N.Y.S.2d 238 (N.Y. 1973) ("An agent's power to bind

his principal is coextensive with the principal's grant of authority.").[1] As we have explained:

> Actual authority is created by direct manifestations from the principal to the agent, and the extent of the agent's actual authority is interpreted in the light of all circumstances attending those manifestations, including the customs of business, the subject matter, any formal agreement between the parties, and the facts of which both parties are aware.

Peltz v. SHB Commodities, Inc., 115 F.3d 1082, 1088 (2d Cir. 1997) (internal quotation marks omitted).

To conclude that Rauch had actual authority to enter a contract to sell the notes at fifty-one, a jury would have to find that the Schneiders authorized a sale of the notes at that price or that they had authorized Rauch to exercise discretion as to the terms of the sale. Leonard Schneider and Rauch, of course, expressly denied that the Schneiders authorized the sale of the notes at fifty-one, Trial Tr. 537-38, 837, and nothing in the record supports a finding that the Schneiders gave Rauch such authorization. At the time of the last recorded call on March 14, ten minutes prior to the unrecorded call, they had not done so, and Appellees put forward no evidence that the Schneiders gave Rauch any further authorization

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[1] The parties do not dispute that New York law governs the questions of contract and agency law that arise in this appeal.

in the ten intervening minutes. Indeed, it is virtually inconceivable that they would have done so after learning that McNaughton was likely to be acquired and then to pay the notes at their face amount.

Nor does the record contain evidence that Rauch had actual authority to conclude a contract without obtaining the Schneiders' agreement to the terms. The Letter Agreement unequivocally states that "the consummation of any transaction remains in the sole discretion and satisfaction of" the Schneiders and RBC. All the evidence of the behavior of the parties during the course of the negotiations further confirmed that the Schneiders withheld authorization from Rauch to conclude a contract on their behalf without their consent to the terms. Rauch presented firm offers to RBC only after obtaining the Schneiders' permission to do so, and he presented RBC's offers to the Schneiders before responding to them. There was, therefore, no basis upon which a jury could conclude that Rauch had received actual authorization to enter into a contract without the Schneiders' express agreement to its terms, which he never received.

Appellees' primary argument in support of a finding that Rauch had actual authority to enter into a contract for a sale of the notes at fifty-one is that "customs of business," *Peltz*, 115 F.3d at 1088, imply that Rauch had actual authority to "accept a price on behalf of his clients." Pl.'s Br. at 38. They argue, "[T]here is no evidence that [the Letter Agreement] foreclosed the possibility that Rauch would be

communicating the Schneiders' approval of the transaction." *Id.* This may be true, but the crucial question is not whether Rauch could "accept a price" on behalf of the Schneiders, but whether he could do so without their authorization. Likewise, the question is not whether Rauch was authorized to "communicat[e] the Schneiders' approval," but whether he had received the Schneiders' approval. There was no evidence that Rauch had authorization to exercise his own discretion on behalf of his principals as to the terms of the transaction. To the contrary, all the evidence showed that Rauch had no actual authority to contract except upon receipt of the sellers' approval of the terms, and there was no evidence that he had received such approval.

II. Apparent Authority

Appellees also contend that Rauch had apparent authority to bind the Schneiders to a contract for the sale of the notes at fifty-one. Where an agent lacks actual authority, he may nonetheless bind his principal to a contract if the principal has created the appearance of authority, leading the other contracting party to reasonably believe that actual authority exists. "Apparent authority exists when a principal, either intentionally or by lack of ordinary care, induces [a third party] to believe that an individual has been authorized to act on its behalf." *Peltz*, 115 F.3d at 1088 (internal quotation marks omitted); *see also Wells Fargo Home Mortgage, Inc. v. Hiddekel Church of God, Inc.*, 1 Misc. 3d 913A, 781 N.Y.S.2d 628, 628

(Sup. Ct. 2004) ("'Essential to the creation of apparent authority are words or conduct of the principal, communicated to a third party, that give rise to the appearance and belief that the agent possesses authority to enter into a transaction.'" (quoting *Standard Funding Corp. v. Lewitt*, 89 N.Y.2d 546, 678 N.E.2d 874, 877, 656 N.Y.S.2d 188 (N.Y. 1997))). However, "[t]he mere creation of an agency for some purpose does not automatically invest the agent with 'apparent authority' to bind the principal without limitation." *Ford*, 299 N.E.2d at 664. A party cannot claim that an agent acted with apparent authority when it "knew, or should have known, that [the agent] was exceeding the scope of its authority." *Sphere Drake Ins. Ltd. v. Clarendon Nat'l Ins. Co.*, 263 F.3d 26, 33 (2d Cir. 2001).

To conclude that Rauch had apparent authority to make the contract, a jury would need to find that the Schneiders induced the reasonable belief by RBC that Rauch made the contract having received the authorization of the Schneiders to do so. *See Peltz*, 115 F.3d at 1088. No evidence suggests that the Schneiders did anything to induce RBC to believe that Rauch was authorized to enter an agreement without their specific assent to its terms. The Letter Agreement expressly advised Appellees that he could not, and Rauch repeatedly confirmed this limitation on his authority throughout his negotiations with RBC. For example, on January 31, when Ambrecht asked for a firm offer, Rauch replied, "I'll tell [the Schneiders] to make you an offer." J.A. 693. He

responded with a firm offer twelve days later, after consulting with the Schneiders.

Rauch had apparent authority, therefore, to conclude an agreement only if the Schneiders induced RBC to reasonably believe that the Schneiders had agreed to make a deal on the terms offered. We assume arguendo that by authorizing Rauch to negotiate with RBC on their behalf, the Schneiders gave Rauch apparent authority to communicate their assent either expressly or by implication (even if they had not in fact assented). Nevertheless, in light of the evidence of the negotiations preceding the unrecorded March 14 phone call, Appellees failed to introduce sufficient evidence for a reasonable finding, by a preponderance of the evidence, that RBC reasonably believed that Rauch had received authorization from the Schneiders to sell the notes at fifty-one.

The recordings of the first two calls on March 14 make clear that, at the times those calls took place, Rauch lacked authority to sell the notes at fifty-one. In the first call, at 9:40 a.m., Rauch told Ambrecht that he had talked to the Schneiders that morning, but that "they didn't even mention" the deal to sell the notes and he was "not going to know before noon" whether the Schneiders wanted to go forward with the trade. J.A. 821. Rauch explained that he could not conclude an agreement until he spoke with the Schneiders, even though Rauch "would have done the trade yesterday." *Id.* Ambrecht asked whether Rauch thought that the Schneiders had "changed their mind," to which Rauch replied, "No, absolutely not."

Id. Ambrecht asked why they "just don't say just do it then," to which Rauch responded, "Well, I will let you know as soon as I know. . . ." *Id.*

In the second recorded call, at 2:18 p.m., Rauch continued to make clear that he could not conclude the deal. Ambrecht told Rauch that he was receiving complaints from one of the firms to which RBC planned to sell the notes. He explained that the agent of the other firm had asked him, "[Y]ou got me to step up and now you're not giving me closure here, now what is going on?" J.A. 837. Rauch responded that he "got a call in to the [Schneiders'] attorney and the attorney's supposedly going to call me back." *Id.* Ambrecht asked whether "we need the attorney for a verbal [agreement]" and Rauch insisted that a verbal agreement was not possible at that point because "[the Schneiders] said they wanted to talk to the attorney." *Id.* He explained, "before I say a word, [the attorney's] going to put the words in my mouth." *Id.* Ambrecht asked whether the Schneiders "more or less see if they can like want this, agree to it, it sounds like now?" *Id.* But Rauch responded, "You know, I don't want to go out on a limb because uh I don't know how he's going to tell me, how this goes, you know." *Id.* Ambrecht asked whether Rauch expected to hear from the lawyer soon, to which Rauch replied, "No, no, f[*]cking attorney . . . if he calls me at five thirty, I'll be delighted." J.A. 839. Ambrecht asked whether "it will be okay then to try to do the trade" if the lawyers settled on the wording, but Rauch was noncommittal, saying "Yeah, I mean the,

based on the, you know, how he tells me to present it, and you know under what conditions and so forth." J.A. 840. Ambrecht again complained that he was receiving "a lot of pressure" to conclude the deal, and Rauch replied, "Hey, if we agreed to the terms two weeks ago, right now we'd go out for dinner tonight . . . [a]nd say I'm glad that's done." J.A. 841. The call ended with Rauch promising, "I'll call you as soon as I know." J.A. 842.

In light of this undisputed evidence of the content of the recorded calls, none of the evidence of the content of the subsequent unrecorded call supports a reasonable belief on RBC's part that Rauch had received authorization from the Schneiders to make the deal in the intervening minutes. Three people participated in the call on RBC's behalf: Ambrecht, Holmes, and Peter Parent, another Co-Head of the High-Yield Group. Neither Holmes nor Parent had been part of the previous negotiations between RBC and Rauch. Although all the participants in the unrecorded call testified at trial as to the content of the call, Parent's account is the only one that provides even an arguable basis for a finding of apparent authority, and it too is insufficient in light of the other undisputed evidence. Parent testified, "I remember . . . that Glen confirmed size and price with us, 69 million at 51, which means that we had a transaction. . . . Glen was going to get the lawyers to send us a confirm so that we could go to a written form of contract." Tr. 151. However, that the "size and price" under discussion were "69 million at 51" was

not in dispute. The issue was whether, under the circumstances, RBC could reasonably understand Rauch to be telling it that the Schneiders had agreed to that price. Parent's addition, "which means that we had a transaction," was a statement about his own thought processes – not Rauch's statements. His belief that they had a contract is insufficient unless the belief was reasonably attributable to Rauch's statements.

Parent's further addition that "Glen was going to get the lawyers to send us a confirm so that we could go to a written form of contract," was ambiguous and in the context also insufficient. *In the absence of other evidence of the communications between RBC and Rauch*, such a statement by a broker in Rauch's position could perhaps reasonably have been understood by RBC as implying that he had received authorization for the contract and that they had a deal. Such ambiguous words, however, could also have represented nothing more than Rauch's expression of his determination to get the deal done. But while either interpretation might be reasonable if the statement were viewed in isolation, the same is not true once the undisputed evidence of the prior negotiations is taken into account. Highland and RBC are entitled to have us consider the evidence in the light most favorable to them in determining whether the jury's verdict in their favor was based on legally sufficient evidence, but we may not disregard undisputed evidence that bears on the interpretation of ambiguous matters. *See Tomassi v. Insignia Fin.*

Group, Inc., 478 F.3d 111, 115-17 (2d Cir. 2007) (evaluating the sufficiency of evidence "in the context of all the evidence"). To prevail on the apparent authority theory, Appellees needed evidence that, taken together with the undisputed evidence of the negotiations, could support a finding that it was more probable than not that RBC reasonably understood Rauch to be saying that he had at last received authorization.

In the context of the other evidence – particularly the undisputed content of the previous recorded calls – a jury could not reasonably find it more probable than not that RBC reasonably understood the words Parent attributed to Rauch to constitute Rauch's affirmation that he had at last received authorization to make the deal. Only ten minutes earlier, Rauch told RBC that he did not have approval for a sale at fifty-one and that he could not agree to the sale unless he received such approval from either the Schneiders or their lawyers. He said that the Schneiders' attorney would be dictating what he should say and that he did not expect to hear anything before the end of the day. He made clear that he hoped to receive the approval and would call RBC immediately if he did. Rauch, however, did not call RBC. And when RBC called him after the passage of only ten minutes, nothing in their conversation

reported by any of the participants suggested that in that intervening ten minutes anything had changed.[2]

Notwithstanding that, upon a different record that contained no other evidence of the known limits of his authority, a broker's statement that he would "get the lawyers to send a confirm" relating to a specified size and price might well be a sufficient basis to support a reasonable belief that the broker had his principal's approval and that the deal was done, we cannot disregard the undisputed evidence of the context. In the context of the extensive undisputed evidence of the dealings between Rauch and RBC, that single ambiguous line Parent attributed to Rauch could not sufficiently establish apparent

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[2] The testimonies of Holmes, Ambrecht, and Rauch are also insufficient to support a finding of apparent authority. Holmes and Ambrecht did not attribute any words to Rauch that would have led RBC to reasonably believe the Schneiders had authorized Rauch to sell at fifty-one, asserting only their own impressions that a deal had been reached. Indeed, Holmes testified that after the call ended he "shrugged and said, I guess we'll have to wait until tomorrow for Mr. Rauch to call us back." Trial Tr. 401-02. Nor does RBC receive any comfort from Rauch's testimony about the call. He testified that he explicitly told RBC that they did not have a deal:

> Max [Holmes] said, Glen, where are we on the transaction? I said, What do you mean? He said, Do we have size and price? I said, No, we don't have size and we don't have price. He said, Then you mean we're nowhere? I said, Yeah, unfortunately that's where we are. He said, OK, that's it, good-bye. And that was it.

Tr. 539.

authority. A jury could not reasonably find it more probable than not that RBC reasonably believed, based on that single sentence, that in the ten minutes since the prior recorded call Rauch had finally received the long-awaited authorization to do the $ 35 million transaction, when Rauch said nothing to suggest that since ten minutes earlier the circumstances had changed. While it is not inconceivable that Rauch's unclear reference to having lawyers send a confirm could have meant that he had received authorization, the complete undisputed circumstances of the call made it so improbable that this was his meaning that RBC could not reasonably draw that inference. A jury could not reasonably conclude, by a preponderance of the evidence, that RBC relied on Rauch's apparent authority to make the deal.

For the same reason, the evidence was insufficient to support a reasonable finding that Rauch expressed agreement to sell the notes during the unrecorded March 14 call or that RBC reasonably construed Rauch's words as expressing agreement to sell at fifty-one. We conclude that, taking all ambiguous or disputed evidence in the light most favorable to the Appellees, but construing it in light of the extensive undisputed evidence, a jury could not reasonably find it more probable than not that Rauch had received authorization to sell at fifty-one, that RBC reasonably believed he had received authorization to sell at fifty-one, or that RBC reasonably understood his words as expressing agreement to sell at fifty-one.

We conclude that the Schneiders were entitled to judgment as a matter of law. We therefore reverse the judgment in favor of Highland and RBC and remand for entry of judgment in favor of the Schneiders.

CONCLUSION

The district court's order denying Defendants' motion for judgment as a matter of law is hereby REVERSED, and the case is REMANDED with instructions to enter judgment in favor of Defendants.

HIGHLAND CAPITAL MANAGEMENT LP,
Plaintiff-Appellant-Cross-Appellee,
-v.-
LEONARD SCHNEIDER, LESLIE SCHNEIDER, SCOTT SCHNEIDER, AND SUSAN SCHNEIDER,
Defendants-Third-Party-Plaintiffs-Counter Defendants-Appellees-Cross-Appellants,
JENKENS & GILCHRIST PARKER CHAPIN LLP, Defendant-Appellee, RBC DOMINION SECURITIES CORP., Third-Party-Defendant-Counter-Claimant-Cross-Appellee.

Docket Nos. 05-4729-cv(L), 05-4869-cv(XAP)

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

460 F.3d 308; 2006 U.S. App. LEXIS 20993; 60 U.C.C. Rep. Serv. 2d (Callaghan) 837

June 15, 2006, Argued
August 15, 2006, Decided

COUNSEL: PAUL B. LACKEY (Jamie R. Welton, on the brief), Lackey Hershman L.L.P., Dallas, Texas, for Highland Capital Management LP.

ALVIN M. STEIN (Katherine C. Ash and Tyler D. Lenane, on the brief), Troutman Sanders LLP, New York, New York, for Leonard, Leslie, Scott, and Susan Schneider.

Robert B. Gilbreath, Jenkens & Gilchrist Parker Chapin LLP, Dallas, Texas for Jenkens & Gilchrist Parker Chapin LLP.

JUDGES: Before: WINTER and RAGGI, Circuit Judges, and CROTTY, District Judge.[1]

OPINION BY: Paul A. Crotty

OPINION

CROTTY, *District Judge*:

Plaintiff-Appellant Highland Capital Management LP ("Highland") appeals from a judgment of the United States District Court for the Southern District of New York (Peter J. Leisure, *Judge*) dismissing counts one through seven of its complaint against Defendants-Appellees Leonard Schneider, Leslie Schneider, Scott Schneider, and Susan Schneider (collectively, the "Schneiders"). While Highland appeals the district court's dismissal of all counts, we dispose of counts three through six in a separate summary order. This decision deals only with the narrow question of whether the promissory notes issued by McNaughton Apparel Group, Inc. ("McNaughton") to the Schneiders fall within the definition of a "security" in Section 8-102(a)(15) of the New York Uniform Commercial Code ("U.C.C."), and therefore are exempt from application of the New York statute of frauds, N.Y. U.C.C. § 1-206(1). The district court found that the notes were not "securities." Recognizing the lack of clarity in New York law regarding

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[1] The Honorable Paul A. Crotty, United States District Judge for the Southern District of New York, sitting by designation.

what constitutes a "security" under Section 8-102(a)(15) of the New York U.C.C., and the importance of this question to the financial community, we certify the question to the New York Court of Appeals. We retain jurisdiction over counts one, two and seven of Highland's Third Amended Complaint – Highland's three contract-based claims – so that, upon receipt of the New York Court of Appeals' answer, we may rule on the remainder of Highland's appeal.

BACKGROUND

The underlying facts of the dispute between Highland and the Schneiders are set out in great detail in the district court's Opinion and Order dated July 25, 2005. *See Highland Capital Mgmt. L.P. v. Schneider,* No. 02-8098, 2005 U.S. Dist. LEXIS 14912, at *8-28 (S.D.N.Y. July 26, 2005). Since we assume familiarity with the district court's decision, we provide here only a brief summary of the facts relevant to the question of whether the subject promissory notes are securities under the New York U.C.C. Like the district court, we construe the facts in the light most favorable to plaintiff, although we recognize the Schneiders' sharp disagreement with many of the allegations advanced.

A. Issuance of the Promissory Notes to the Schneiders

The Schneider defendants owned and operated two apparel companies, Jeri-Jo Knitwear and Jamie

Scott, Inc. (collectively "Jeri-Jo"). On April 15, 1998, the Schneiders sold Jeri-Jo to McNaughton. McNaughton paid $ 55 million, assumed debt worth $ 10.9 million, and promised to pay an earn-out payment based on Jeri-Jo's performance over the next two years.

Owing to Jeri-Jo's success in this two-year period, McNaughton owed the Schneiders approximately $ 190 million in earn-out profits. Originally, the earn-out payments were to be in cash or stock. As a result of McNaughton's poor financial condition at the time the earn-out payments came due, however, McNaughton and the Schneiders agreed that part of the payment would be issued in the form of promissory notes. The parties negotiated and agreed to a total earn-out payment of $ 161 million, with the Schneiders receiving the following combination of cash, stocks and notes: (1) $ 95 million in cash upfront; (2) $ 30 million in cash after McNaughton received new financing; (3) $ 26 million in McNaughton common stock; and (4) $ 10 million in four three-year promissory notes.[2]

As the deadline for the $ 30 million cash payment approached in November 2000, McNaughton asked for an extension until April 2001. The Schneiders declined McNaughton's request for an extension, and

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[2] This first set of promissory notes was issued on August 29, 2000. Leonard Schneider received a note worth $ 4 million, Leslie Schneider and Susan Schneider each received notes worth $ 2.4 million, and Scott Schneider received a note worth $ 1.2 million, for a total of $ 10 million.

instead accepted four additional promissory notes with a total face value of $ 59 million in lieu of the $ 30 million cash payment. This second set of promissory notes was issued on December 1, 2000.[3]

All eight notes were stamped "subordinated promissory note," as they were subordinate to senior creditors and were convertible to stock if McNaughton ever dissolved.[4] The Notes were payable to the individual Schneider to whom the money was owed, not to a generic bearer, but were fully transferrable as long as McNaughton complied with the registration requirements of the Securities Act of 1933.[5]

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[3] Leonard Schneider received a note worth $ 23.6 million, Leslie Schneider and Susan Schneider each received notes worth $ 14,160,000, and Scott Schneider received a note worth $ 7,080,000, for a total face value of $ 59 million.

[4] Because of these qualities, Highland characterizes the notes as "convertible subordinated debentures." *See* Appellant's Br. 5. On summary judgment, the district court rejected this characterization, however, stating that the notes were not identical to debentures because they were not issued "for the purpose of financing and investment." *See* 2005 U.S. Dist. LEXIS 14912, at *11, 49 n.19. Given that the promissory notes were issued in exchange for money otherwise owed, money that McNaughton got to keep and use for financing and investment purposes, the district court's limitation may not be appropriate.

[5] Each Note contained at the top the following restrictive legend:

> THIS NOTE HAS NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED. IT MAY NOT BE TRANSFERRED IN THE ABSENCE OF AN EFFECTIVE REGISTRATION STATEMENT UNDER SUCH ACT OR AN OPINION OF COUNSEL TO THE MAKER

(Continued on following page)

The Schneiders' ability to find a suitable buyer for the notes was limited, however, by the fact that all of the promissory notes were considered high-risk debt due to the uncertainty about McNaughton's ability to pay them off. All notes indicated that they were to be "governed by and construed in accordance with" New York law.

B. Potential Sale of Promissory Notes by the Schneiders

In late 2000 and early 2001, the Schneiders decided to price the notes. They engaged Glen Rauch, a broker-dealer acting through his company Glen Rauch Securities, Inc. ("Rauch"), for this purpose. Rauch, in turn, engaged RBC Dominion Securities Corp. ("RBC") as an agent and exclusive broker for the purpose of marketing the notes. RBC was to act as a "riskless principal" in the deal, meaning that RBC agreed it would purchase the notes from the Schneiders (through Rauch) and then "flip" the notes by selling them to a third-party purchaser at a premium. As a "riskless principal," RBC would not actually "purchase" the notes until the third-party end-purchaser was already lined up and ready to complete the final purchase, so that RBC would not assume any risk in the transaction. In this sense, RBC would be both a

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[MCNAUGHTON] THAT SUCH REGISTRATION IS NOT REQUIRED.

(J.A. A-520, A-532, A-544, A-558, A-569, A-580, A-591, A-602.)

seller and a buyer in the deal, an arrangement common in the financial world.

Sometime in January 2001, RBC found a buyer for the notes, Plaintiff Highland, and negotiations between RBC and Highland over price ensued. Highland allegedly agreed to purchase $ 45.4 million worth of the notes at a price of 52.5 cents on the dollar.[6] On March 14, 2001, Rauch allegedly informed RBC that the Schneiders had agreed to the transactions, and the parties entered an oral agreement to carry out the trade.[7] As is customary in the financial industry, these negotiations were telephonically recorded, rather than memorialized on paper. These recordings allegedly reflect that throughout the course of negotiations, all parties considered the notes to be "tradeable securities," which could be sold only by a

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[6] The $ 45.4 million represents 7 out of 8 of the notes. Fidelity, an unrelated company, agreed to purchase the remaining Note. Under the agreement, RBC would buy the notes from the Schneiders at 51 cents on the dollar and Highland would then buy the notes from RBC at 52.5 cents on the dollar. This spread of 1.5 cents on the dollar was to be RBC's compensation for the deal.

[7] The Schneiders never spoke directly to Highland about the trade. The oral agreement, if it was actually reached, was formed between the Schneiders and Highland through Rauch and RBC as intermediaries. The Schneiders allege that they never agreed to the trade on March 14, 2001, but RBC and Highland claim that, in an unrecorded conversation on March 14, 2001, Rauch confirmed a sale of $ 45.4 million in notes to Highland for 51 cents on the dollar.

broker-dealer with an applicable securities license to a buyer who qualified as an "accredited investor."

On or about March 9, 2001, the Schneiders allegedly learned that Jones Apparel Group ("Jones") intended to acquire McNaughton, an acquisition that would require the eight notes to be paid in full. Based on this information, the Schneiders decided not to sell the notes, and therefore refused to settle the trade with Highland. Three weeks later, Jones's acquisition of McNaughton was announced to the public, and the Schneiders' notes were paid off in full.[8]

C. Procedural History

On October 18, 2001, Highland brought suit against the Schneiders in Texas state court for breach of contract, tortious interference with contractual relations, and third-party beneficiary breach of contract.[9] The Schneiders removed the case to the Northern District of Texas based on diversity of citizenship

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[8] The Schneiders received $ 69 million as a result of the payout. If the Schneiders had settled the trade with Highland and Fidelity, the Schneiders would have received only $ 35.2 million dollars ($ 0.51 cents on the dollar).

[9] Highland's claim for third-party beneficiary breach of contract is premised on a theory that the Schneiders and RBC entered into an agreement, through Rauch, for the benefit of Highland. Therefore, the Schneiders' breach of its agreement with RBC injured Highland. RBC intended to act as a "riskless principal" in the sale, purchasing the notes from the Schneiders and then immediately reselling them to third-party purchasers (in this case, Highland and Fidelity) at a premium.

under 28 U.S.C. § 1332(a), and the case was later transferred to the Southern District of New York. After transfer, the Schneiders answered, denying that they ever made an agreement with Highland to sell the notes and asserting, among other things, a defense of the statute of frauds.

At the close of discovery, the Schneiders moved for summary judgment and judgment on the pleadings to dismiss Highland's claims against them. The district court granted Defendants' motions for summary judgment and judgment on the pleadings, dismissing counts one through six of Highland's complaint on the merits pursuant to Federal Rules of Civil Procedure 12(c) and 56, and dismissing count seven of Highland's complaint for lack of subject matter jurisdiction pursuant to 28 U.S.C. § 1332(a) and Federal Rule of Civil Procedure 12(b)(1). Highland now appeals.

DISCUSSION

I. ISSUE RAISED IN THIS APPEAL

While Highland raises a number of issues on appeal, this decision addresses only the narrow and highly specific issue of whether the eight promissory notes issued by McNaughton to the Schneiders are "securities" as the term is defined in Section 8-102(a)(15) of the New York U.C.C. This question is directly relevant to our review on appeal, as it determines whether the alleged oral agreement to sell the notes in March 2001 is subject to the New York

statute of frauds, N.Y. U.C.C. § 1-206(1).[10] If the statute of frauds applies, then this court may well lack subject matter jurisdiction to review the district court's dismissal of Highland's contract-based claims. If the statute of frauds does not apply, then this Court would have to address the serious possibility that the district court's dismissal of these claims was in error.

A. Section 8-102(a)(15) of the New York Uniform Commercial Code

The current version of the New York U.C.C. defines a "security" as:

> [A]n obligation of an issuer or a share, participation, or other interest in an issuer . . .

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[10] The New York Uniform Commercial Code requires that any contract for the sale of personal property over five thousand dollars be in writing, "signed by the party against whom enforcement is sought or by his authorized agent." N.Y. U.C.C. § 1-206(1). Because "the statute of frauds is unsuited to the realities of the securities business," the sale of "securities" is exempt from the writing requirement set forth in Section 1-206(1). *See* N.Y. U.C.C. § 8-113(a) & cmt. The provision states: "[A] contract or modification of a contract for the sale or purchase of a security is enforceable whether or not there is a writing signed or record authenticated by a party against whom enforcement is sought." N.Y. U.C.C. § 8-113(a). Therefore, if the Schneiders' promissory notes are "securities," then an oral agreement to sell the notes would be enforceable, potentially rendering the district court's grant of summary judgment for defendants erroneous.

> (i) which is represented by a security certificate in bearer or registered form, or the transfer of which *may be* registered upon books maintained for that purpose by or on behalf of the issuer;
>
> (ii) which is one of a class or series or by its terms is divisible into a class or series of shares, participations, interests, or obligations; and
>
> (iii) which . . . is, or is of a type, dealt in or traded on securities exchanges or securities markets. . . .

N.Y. U.C.C. § 8-102(a)(15) (emphasis added).

B. The District Court's Analysis of the Schneiders' Notes Under Section 8-102(15)

The district court held that the Schneiders' promissory notes were not "securities" under Section 8-102(a)(15) of the New York U.C.C. because the notes were neither "represented by a security certificate in bearer or registered form," nor "registered upon books maintained for [the purpose of recording transfer] by or on behalf of the issuer," as required under subsection (i) of the definition. The district court said the notes were "not represented by a certificate," because they were "signed by the maker, McNaughton, and represented as a note of payment due." *See Highland*, 2005 U.S. Dist. LEXIS 14912, at *44.

Neither the plain language of the statute nor the accompanying commentary are clear about what

constitutes a "certificate" for U.C.C. purposes. The New York U.C.C. defines a "security certificate" in a rather circular fashion, as "a certificate representing a security." N.Y. U.C.C. § 8-102(16). There are two possible meanings: either "certificate" refers to a specialized document e.g., the paper certificates that have traditionally been used to represent stocks, or "certificate" refers to any paper used to embody the underlying intangible interest. *See* N.Y. U.C.C. § 8-102(16) & cmt n.16. If the term "certificate" refers to the latter, then the promissory notes, each of which is evidenced by a twelve-page writing, would meet the definition of "certificate"; if the term "certificate" refers to the former, i.e., a specialized document such as a stock certificate, then it is correct to find that the Schneiders' notes are "not represented by a certificate." There is no New York case law clarifying what constitutes a "certificate" for purposes of Section 8-102.

Assuming the district court is correct that the Schneiders' notes are "not represented by a certificate," then the notes must be analyzed under the second clause of subsection (i), which addresses "uncertificated securities." *See* N.Y. U.C.C. § 8-102 cmt. n.15 (explaining that subsection (i) is structured in the alternative, so that an interest or obligation is a "security" if "the issuer *either* maintains transfer books *or* the obligation or interest is represented by a certificate in bearer or registered form" (emphasis added)); *see also* N.Y. U.C.C. § 8-102(a)(18) (defining an "uncertificated security" as "a security that is not

represented by a certificate"). The second clause of subsection (i) provides that an uncertificated obligation or interest is a "security" only if "the transfer of [the obligation or interest] *may be* registered upon books maintained for that purpose by or on behalf of the issuer." N.Y. U.C.C. § 8-102(a)(15)(i) (emphasis added). Applying this language, the district court found that "there [was] no evidence that the transfer is registered on 'books maintained for that purpose by or on behalf of the issuer,'" and therefore the notes could not be "securities" as a matter of law. *See Highland,* 2005 U.S. Dist. LEXIS 14912, at *44-46.

We are not certain that the district court's analysis was correct. Subsection (i) does not require that transfer of the obligation or interest actually be registered on books maintained for that purpose, as the district court's opinion suggests, but only that they *may be* registered on such books. Therefore, we believe that the proper inquiry is whether the notes *could have been* registered on transfer books maintained by McNaughton, not whether they were registered on transfer books at the time of the litigation.

Moreover, some record evidence suggests that the Schneiders' notes may have been registered on transfer books. Specifically, each note contained a restrictive legend providing that the notes could "not be transferred in the absence of an effective registration statement" or an "opinion of counsel to the maker that such registration is not required." (J.A. A-520, A-532, A-544, A-558, A-569, A-580, A-591, A-602.) Registration for the purpose of the Securities Act of

1933, as the restrictive legend requires,[11] is not the same as registration on the books of the corporation for purposes of transfer, as the New York U.C.C. definition of a "security" requires. The existence of the restrictive legend suggests, however, that McNaughton would have had to monitor the notes in some manner, in order to ensure compliance with the registration requirements indicated in the legend. Such monitoring is usually done through the use of transfer books. Thus, even if McNaughton chose not to maintain separate books to monitor the transfer of the Schneiders' notes, McNaughton could have – and perhaps should have – maintained such books.

Further, each Note required that McNaughton make substantial quarterly principal payments and monthly interest payments at 9-3/4 % to each of the holders. These payments were recorded on the books of the corporation. As Highland points out, the continued existence of these payment obligations suggests that McNaughton would have had to record the transfer of the notes on special transfer books in order to identify the holders to whom these payments were due. Thus, transfer of the promissory notes may

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[11] When McNaughton issued the promissory notes to the Schneiders, the issuance was reported to the SEC, and an appropriate press release was published announcing the issuance to the public. While this is done for SEC purposes, without any consideration of the New York U.C.C., it suggests that McNaughton regarded the notes as "securities."

have been registered upon books maintained for that purpose by or on behalf of McNaughton.

The drafters' use of the words "may be" is explained perhaps by Section 8-401 of the New York U.C.C., entitled "Duty of Issuer to Register Transfer." Section 8-401 provides that "[i]f a certificated security in registered form is presented to an issuer with a request to register transfer or an instruction is presented to an issuer with a request to register transfer of an uncertificated security, the issuer" must register the transfer as long as certain requirements are met. Reading subsection (i) of Section 8-102(a)(15) in light of Section 8-401, the phrase "*may be* registered" in Section 8-102(15)(i) likely means that the obligation or interest is of the type that Section 8-401 requires the issuer to register, if instructed to do so. Thus, contrary to the Schneiders' suggestion in their opposition brief, giving effect to the term "may be" does not necessarily mean that it will be "limitless" in scope. *See* Appellee's Br. 43. We recognize, however, that neither the New York U.C.C. nor the New York courts have defined the contours of subsection (i), and therefore whether the Schneiders' notes meet the first prong of the tripartite test for a "security" under the New York U.C.C. remains unresolved.

Since the District Court found that the notes do not meet the first prong of Section 8-102(a)(15), it did not analyze whether the notes meet the second and third prongs. We believe that they do. The question of whether the Schneiders' notes were "of a class or series" is answered by the terms of the notes

themselves. In total, McNaughton issued eight notes: notes in August 2000, and 4 notes in December 2000. As such, the notes are clearly divisible into "a class or series," so the second prong of Section 8-102(15) is satisfied. *See, e.g., Baker v. Gotz,* 387 F. Supp. 1381, 1390 (D. Del. 1975) (finding that a note was "patently 'one of a class or series'" where six notes were issued, five in the amount of 4,000,000 Swiss francs and the sixth in the amount of 5,360,000).

While the Schneiders' notes were not actually traded on a securities exchange or securities market, they were "of a type" dealt in securities exchanges or markets. *See, e.g., In re Domestic Fuel Corp.,* 70 B.R. 455, 462 (Bankr. S.D.N.Y. 1987) (noting that "whether or not there is a market for the particular instrument is not the controlling factor, if the instrument is 'of a type commonly dealt in upon securities exchanges or markets'" (quoting Practice Commentary accompanying Section 8-102)); *Baker v. Gotz,* 387 F. Supp. at 1390 (same). Support for this position may be found in the record itself. In a recorded conversation between James Alterbaum, a partner at Jenkins Gilchrist Parker Chapin, the law firm representing the Schneiders, and Ken Ambrecht, a broker at RBC, Alterbaum allegedly referred to the notes as "freely tradeable securities." (J.A. A-914.) Glen Rauch, a broker-dealer, also referred to the notes as "tradeable securities" and stated that he "wouldn't even think of" trading without an applicable securities license. (J.A. A-914, A-1422 to A-1427.) Moreover, the fact that the Schneiders retained securities professionals

to sell the notes, and these professionals found willing buyers for the notes, demonstrates that the notes are "of the type dealt in or traded on securities . . . markets." Therefore, the third prong of Section 8-102(a)(15) is satisfied.

II. CERTIFICATION TO THE NEW YORK COURT OF APPEALS

The parties do not dispute that New York law governs this diversity action. We review *de novo* the district court's interpretation of New York law. *See Salve Regina Coll. v. Russell,* 499 U.S. 225, 231, 111 S. Ct. 1217, 113 L. Ed. 2d 190 (1991). Where, as here, the New York Court of Appeals has not yet spoken on the issue before the Court, we must either (1) predict how the New York Court of Appeals would resolve the question, or (2) certify the question to the New York Court of Appeals for a definitive resolution. *See* 2d Cir. R. § 0.27 (permitting us to certify "to the highest court of a state an unsettled and significant question of state law that will control the outcome of a case"); N.Y. Comp. Codes R. & Regs. tit 22, § 500.27(a) (authorizing certification of "determinative questions of New York law . . . for which no controlling precedent of the [New York] Court of Appeals exists"); *Morris v. Schroder Capital Mgmt. Int'l,* 445 F.3d 525, 530-31 (2d Cir. 2006); *DiBella v. Hopkins,* 403 F.3d 102, 111 (2d Cir. 2005).

We resort to certification sparingly, mindful that "it is our job to predict how the [New York Court of

Appeals] would decide the issues before us." *See DiBella*, 403 F.3d at 111 (quoting *Elliott Assocs., L.P. v. Banco de la Nacion*, 194 F.3d 363, 370 (2d Cir. 1999)). Therefore, we do not certify questions of law "where sufficient precedents exist for use to make [a] determination." *Id.* Where a "statute's plain language does not indicate the answer," however, certification is permissible. *Riordan v. Nationwide Mut. Fire Ins. Co.*, 977 F.2d 47, 51 (2d Cir. 1992); accord *McGrath v. Toys "R" Us, Inc.*, 356 F.3d 246, 250 (2d Cir. 2004). In determining whether to certify a question, we consider three primary issues: "(1) the absence of authoritative state court interpretations of the state statute; (2) the importance of the issue to the state, and whether the question implicates issues of state public policy; and (3) the capacity of certification to resolve the litigation." *Morris*, 445 F.3d at 531 (internal citations and quotation marks omitted). After careful consideration of these factors, we believe that certification is appropriate in this case.

A. Is this an Unsettled Area of New York Law?

1. New York Court of Appeals

While there is "scant caselaw" emanating from the New York courts on what constitutes a "security" under Section 8-102 of the New York U.C.C., we are not entirely without guidance. The New York Court of Appeals has stated that "[A]rticle 8 of the Uniform Commercial Code . . . governs stocks, bonds and other evidences of indebtedness." *Vigilant Ins. Co. of Am. v.*

Hous. Auth. of El Paso, 87 N.Y.2d 36, 43, 660 N.E.2d 1121, 637 N.Y.S.2d 342 (1995). Other than reciting the language of Section 8-102(15), however, the Court of Appeals did not elaborate in *Vigilant Insurance* on what "other evidences of indebtedness" constitute "securities" for purposes of the New York U.C.C. The Court of Appeals has never addressed the specific question of whether promissory notes are – or in certain defined circumstances can be – "securities" under the New York U.C.C. Therefore, there is no controlling precedent on this issue.

2. Lower New York courts

The Appellate Division, First Department has recognized that promissory notes are undoubtedly "securities" for purposes of the Martin Act, New York's counterpart to the Securities and Exchange Acts of 1933 and 1934. *See ALH Props. Ten, Inc. v. 306-100th St. Owners Corp.*, 191 A.D.2d 1, 9, 600 N.Y.S.2d 443 (1st Dep't 1993) (reciting the definition of a "security" for purposes of the Martin Act, N.Y. Gen. Bus. L. § 352); *see also* N.Y. Gen. Bus. L. § 352 (including in the definition of a "security" any "note" or "evidence of indebtedness"); 15 U.S.C. § 77b(1) (same). The First Department cautioned, however, that the statutory definition of "security" contained in Section 8-102(15) of the New York U.C.C. is not identical to the term "security" as used in the context of federal and state securities regulation or other New York statutes:

> "In General Business law, § 359-m(f), the 'Uniform Act for Simplification of Fiduciary Security Transfers', the term ["security"] is stated to include 'any share of stock, bond, debenture, note or other security issued by a corporation which is registered as to ownership on the books of the corporation'.
>
> "The New York 'Blue Sky Law' uses the term to cover 'stocks, bonds, notes, evidences of interest or indebtedness or other securities, including oil and mineral deeds or leases and any interest therein, sold or transferred in whole or in part to the purchaser where the same do not effect a transfer of the title in fee simple to the land, or negotiable documents of title, or foreign currency orders, calls or options therefor . . . ' General Business Law, § 352(1)." (McKinney's Cons Laws of NY, Book 62 A 1/2, UCC 8-102, at 129.) The New York Annotations conclude by noting that the "Code definition, applicable to Article 8, is broader than the definition in General Business Law, § 359-m (f), narrower than that in General Business Law, § 352(1), and more nearly in accord with the definition found in *Matter of Waldstein,* 160 Misc. 763, 766-67, 291 N.Y.S. 697, 700 (1936) ('instruments for the payment of money, or evidencing title or equity, with or without some collateral obligation, and which are commonly dealt in for the purpose of financing and investment'.)" (*Ibid.*)

Id. at 9; accord *Gardner v. Lefkowitz,* 97 Misc. 2d 806, 812, 412 N.Y.S.2d 740 (N.Y. Sup. Ct., N.Y. Co. 1978).

The definition of a "security" articulated in *In re Waldstein,* and adopted by the First Department in *ALH Properties* as the definition of a "security" for purposes of Article 8 of the New York U.C.C., is broad enough to encompass the Schneiders' promissory notes. Similarly, the New York County Supreme Court, Appellate Term, observed in *Cohn, Ivers & Co. v. Gross*, that "any form of instrument used for the purpose of financing and promoting enterprises, and which is designed for investment, is a security" for purposes of the New York U.C.C. *See* 56 Misc. 2d 491, 494, 289 N.Y.S.2d 301 (N.Y. App. Term, 2d & 11th Dist. 1968). A promissory note fits that definition. Other than these few cases, however, no New York have endeavored to define what constitutes a "security" for purposes of the New York U.C.C.

3. Federal courts interpreting the U.C.C.

The few federal cases on this issue support the conclusion that the U.C.C. definition of a "security" includes notes of the type held by the Schneiders. In *Baker v. Gotz,* for example, the Delaware District Court expressly held that three subordinated promissory notes issued by Delaware corporations were "securities" under Section 8-102 as it existed in both Delaware and New York at the time.[12] *See* 387

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[12] The definition of a "security" contained in Section 8-102 in 1975, when *Baker v. Gotz* was decided, was as follows:

> (a) A "security" is an instrument which (i) is issued in bearer or registered form; and (ii) is of a type

(Continued on following page)

F. Supp. at 1389-90. Like the promissory notes in our case, the notes analyzed in *Baker v. Gotz* were subordinated notes issued by large corporations and payable to specific entities named on the notes. *See id.* at 1385-86. While the court in *Baker v. Gotz* reviewed the notes to determine if they were attachable in Delaware, rather than to determine if an oral agreement for sale of the notes was barred by the statute of frauds, there is no indication in the U.C.C. or the case law that the definition of "securities" would differ for these two purposes.

> commonly dealt in upon securities exchanges or markets or commonly recognized in any area in which it is issued or dealt in as a medium for investment; and (iii) is either one of a class or series or by its terms is divisible into a class or series of instruments; and (iv) evidences a share, participation or other interest in property or in an enterprise or evidences an obligation of the issuer.

Baker v. Gotz, 387 F. Supp. at 1389. Both Delaware and New York had adopted identical language.

This definition is almost identical to the definition set forth in the current version of Section 8-102, except subsection (i) now includes additional language. Under this new language, an obligation or interest does not need to be "in bearer or registered form" to be a "security," as long as it is of the type "the transfer of which may be registered upon books maintained for that purpose by or on behalf of the issuer." *See* N.Y. U.C.C. § 8-102(a)(15)(i). If anything, this newly added language appears to broaden the definition of a "security," thereby suggesting that the finding of the Delaware court in *Baker v. Gotz* that the promissory notes were "securities" under Section 8-102 would apply with equal force today.

Judge Cabranes's decision in *S.N. Phelps & Co. v. Prudential Insurance Company of America,* No. 91 Civ. 451, slip. op (D. Conn. Nov. 22, 1991), is also instructive.[13] The question in *S.N. Phelps* was "whether SNP and Prudential entered into a binding oral agreement . . . for the purchase by SNP and the sale by Prudential of $ 75 million (face amount) 12.75 % Senior Subordinated Notes."[14] Slip op. at 1. Applying the New York version of the U.C.C., Judge Cabranes treated the notes as "securities."[15] *See id.* at 24. While Judge Cabranes held that SNP's alleged oral contract for the sale of the notes was barred by the statute of frauds, this holding was based on Section 8-319, the then-existing statute of frauds governing the purchase and sale of securities. Section 8-319 was repealed in 1997, and replaced by Section 8-113, the provision at issue in this case. *See* N.Y. U.C.C. § 8-113 note & cmt. Thus, any oral agreement

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[13] A copy of this decision is found in the Joint Appendix, vol. 1, at A-485 to A-519.

[14] The only difference between the Schneider notes and the S.N. Phelps notes appears to be that the Schneider notes were issued to cover a debt already owed for the purchase of the Schneiders' company, while S.N. Phelps notes were purchased from the issuer in exchange for a cash payment by the defendant holder. The classification of a financial instrument should not turn on whether the holder of the instrument paid in cash or in kind (i.e.., by handing over a business), however, and therefore the notes are, for all relevant purposes, identical.

[15] Interestingly, Judge Cabranes assumed the notes were "securities" under the New York U.C.C. without any discussion of the matter.

previously unenforceable by the Section 8-319 statute of frauds now falls within Section 8-113's exemption to the statute of frauds. Applying Judge Cabranes's logic to the present case, then, the Schneiders' notes would be "securities" exempted from the statute of frauds by Section 8-113.

4. The district court's treatment of the case law

The district court read *ALH Properties* and *Cohn, Ivers* as requiring that "the instruments alleged to be securities represent an investment in the issuing company." *Highland,* 2005 U.S. Dist. LEXIS 14912, at *47-48. Since the debt evidenced by the Schneiders' notes "did not finance McNaughton's company analogous to a stock share," the Court concluded that the Schneiders' notes were not investment instruments. *Id.* The New York courts have yet to speak on whether promissory notes of the type at issue in this case are properly seen as "investments," and therefore "securities" for U.C.C. purposes. Other sources suggest that "investment" has a broader meaning than the district court's finding. The dictionary defines "investment" as: "[T]he commitment of funds with a view to minimizing risk and safeguarding capital while earning a return." Webster's Third New Int'l Dictionary 1190 (2002). The Schneiders' promissory notes fit comfortably within this definition. In fact, promissory notes are often used as a "medium for investment." *See, e.g.*, Circular Letter No. 17 (2000), May 22, 2000, N.Y. Dep't of Insurance (noting that

promissory notes are often sold by licensed insurance agents as a form of investment), at www.ins.state.ny.us/cl00_17.htm; Broken Promises: Promissory Note Fraud, U.S. Securities & Exchange Commission (explaining that "promissory notes can be legitimate investments"), available at www.sec.gov/investor/pubs/promise.htm. The Schneiders held their notes as any other secure investment, collecting monthly interest payments on each note and expecting return of the principal over time. Further, the notes were marketed to third-party purchasers, i.e., Highland and Fidelty, as a medium for investment, just like any other debt instrument.

Moreover, it is clear from the record that McNaughton, a publicly traded company, could have paid the Schneiders in its stock rather than notes. If so, the Schneiders would clearly hold securities. The fact that they took notes instead of stocks should not change the analysis. There is no good reason why notes issued in lieu of stock should not be considered "investment instruments," whereas stock issued by a company to finance the same transactions are "investment instruments." To hold otherwise exalts form over function, and ill serves the needs of the financial marketplace.

B. Is This an Important Issue of New York Law and Policy?

The unresolved issue of whether promissory notes constitute "securities" for purposes of Article 8

of the New York U.C.C. raises legal and policy issues that we believe are best resolved by the New York Court of Appeals. The lack of congruence between the regulatory definition of a security and the U.C.C. definition of a "security" creates confusion and uncertainty within the financial world. As previously noted, promissory notes like the ones in this case are undoubtedly "securities" for purposes of the Martin Act and the Securities and Exchange Acts of 1933 and 1934. *See* 15 U.S.C. § 77b(1); N.Y. Gen. Bus. Law § 352(1). But the few New York cases that have addressed the issue have said that the definition of a "security" for purposes of the New York U.C.C. is more narrow than the definition of a "security" for federal and state regulatory purposes. *See, e.g., ALH Props Ten v. 306-100th St. Owners Corp.,* 191 A.D.2d 1, 9-10, 600 N.Y.S.2d 443. These strained distinctions create problems in the marketplace. Understanding the notes to be "securities," brokers and other industry professionals are not structuring their deals differently to accommodate the more narrow U.C.C. definition. As a result, the rights and duties of buyers and sellers in the marketplace differ depending upon what sort of financial asset they are trading, even when these assets are being sold in the same manner, by the same clients, through the same brokers. Imposing such uncertainty upon the financial community risks deterring the trading of promissory notes in financial markets, thereby restricting the free flow of capital. This is an undesirable result anywhere, but particularly here in New York, the financial capital.

New York sources offer differing advice on how to resolve this unintended discord. The legislative notes accompanying the U.C.C. suggest that the courts should expand the definition of "security" to include promissory notes. Section 1-102 of the U.C.C. mandates that the U.C.C. is to be "liberally construed and applied to promote its underlying purposes and policies." N.Y. U.C.C. § 1-102(1). The three primary purposes and policies of the New York U.C.C. are: "(a) to simplify, clarify and modernize the law governing commercial transactions; (b) to permit the continued expansion of commercial practices through custom, usage and agreement of the parties; and (c) to make uniform the law among the various jurisdictions." N.Y. U.C.C. § 1-102(2)(a)-(c). The official comment accompanying Section 1-102 makes clear:

> This Act is drawn to provide flexibility so that, since it is intended to be a semi-permanent piece of legislation, it will provide its own machinery for expansion of commercial practices. It is intended to make it possible for the law embodied in this Act to be developed by the courts in the light of unforeseen and new circumstances and practices. However, the proper construction of the Act requires that its interpretation and application be limited to its reason.
>
> Courts have been careful to keep broad acts from being hampered in their effects by later acts of limited scope. They have recognized the policies embodied in an act as applicable in reason to subject-matter which

> was not expressly included in the language of the act. They have done the same where reason and policy so required, even where the subject-matter had been intentionally excluded from the act in general. They have implemented a statutory policy with liberal and useful remedies not provided in the statutory text. They have disregarded a statutory limitation of remedy where the reason of the limitation did not apply. Nothing in this Act stands in the way of the continuance of such action by the courts.
>
> The Act should be construed in accordance with its underlying purposes and policies. The text of each section should be read in the light of the purpose and policy of the rule or principle in question, as also of the Act as a whole, and the application of the language should be construed narrowly or broadly, as the case may be, in conformity with the purposes and policies involved.

N.Y. U.C.C. § 1-102 cmt n.1 (internal citations omitted). Thus, "the question whether a given arrangement [fits a definition provided in the U.C.C.] should be decided not by dictionary analysis of the words of the definition taken out of context, but by considering whether it promotes the objectives of [the Article]." N.Y. U.C.C. § 8-501 cmt. n.1.

The statutory notes accompanying Article 8 further advise that Article 8 is intended "to promote uniformity with the laws of other states so that the securities market will function in such a way that it

will be more stable, and so that investors, both individual and corporate, will be more secure and their rights and interests better protected." L. 1997, ch. 566, § 1. The pre-1997 comment to Section 8-102 also advised that the term "security" is "functional rather than formal," and therefore "[t]he ambit of the definition will change as 'securities' trading practices evolve to include or exclude new property interests." *See ALH Props.*, 191 A.D.2d at 9 (quoting former comment 2 to New York U.C.C. § 8-102). On this record, there was a wealth of evidence that the Schneiders' notes were treated as "securities" by all who touched them, suggesting that perhaps the time has come to expand "the ambit of the definition" of Section 8-102(15) "security" to include the Schneiders' promissory notes.

Because the federal securities laws treat promissory notes issued by publicly traded corporations as "securities," brokers sell them in the same manner as they would other federal securities. They do not alter their selling practices to accommodate the more restricted definition of a "security" contained in the New York U.C.C. As such, financial professionals sell promissory notes in the same manner as stocks or bonds: through the use of electronic and telephonic means of record rather than through a series

of writings.[16] As the U.C.C. recognized almost a decade ago:

> With the increasing use of electronic [and telephonic] means of communication, the statute of frauds is unsuited to the realities of the securities business. For securities transactions, whatever benefits a statute of frauds may play in filtering out fraudulent claims are outweighed by the obstacles it places in the development of modern commercial practices in the securities business.

N.Y. U.C.C. § 8-113 cmt. This holds true regardless of whether the broker-dealer is trading a note, stock, bond or any other security. There is no good reason to deny the benefit of Section 8-113 to notes (as opposed to stocks, bonds or other securities) sold by the same industry professionals, yet this would be the inevitable result of finding that promissory notes are not "securities" under Article 8 of the New York U.C.C.

On the other hand, the U.C.C. has also cautioned that "the meaning of the statute itself must be found in its text," *see* N.Y. U.C.C. § 1-102 cmt. 2, and no New York court has yet declared that the text of Section 8-102(a)(15) includes promissory notes. The district court in this case believed that including promissory notes would expand Section 8-102(a)(15) too far. With such minimal and conflicting guidance

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[16] The RBC Compliance Manual suggests that this is standard practice among securities professionals. (*See* J.A. A-330 to A-334.)

from the New York courts, however, we believe this tension is better resolved by the New York Court of Appeals.

C. Capacity of Certification to Resolve the Litigation

The resolution of this issue determines, in large part, the outcome of this appeal, certainly with respect to the seventh claim set forth in Highland's Third Amended Complaint: whether it was a third-party beneficiary to the purported contract between the Schneiders and RBC. The District Court found (1) that a genuine issue of material fact existed as to whether RBC and the Schneiders had entered into a contract, (2) that there was a genuine issue of material fact as to whether the contract was intended for Highland's benefit, and (3) that the purported benefit to be derived from Highland was sufficiently immediate to be protectable. *See Cal. Pub. Employees' Ret. Sys. v. Shearman & Sterling,* 95 N.Y.2d 427, 434-35, 741 N.E.2d 101, 718 N.Y.S.2d 256 (2000) (identifying the elements of a third-party beneficiary claim). Nevertheless, the district court concluded that it lacked jurisdiction to hear this claim because the applicable statute of frauds, N.Y. U.C.C. § 1-206(1), limited Highland's recovery on the third-party beneficiary claim to $ 5,000 and the claim thus failed to satisfy the $ 75,001 threshold set forth in 28 U.S.C. § 1332(a). If the notes are "securities," however, the statute of frauds does not apply. Section 8-113 clearly states: "[A] contract or modification of a contract for

the sale or purchase of a security is enforceable whether or not there is a writing signed or record authenticated by a party against whom enforcement is sought." N.Y. U.C.C. § 8-113(a). Therefore, if the Schneiders' promissory notes are "securities" for purposes of the New York U.C.C., the district court's application of the statute of frauds – and hence its conclusion that Highland's recovery was limited to $ 5,000 – was not correct.[17]

CONCLUSION

Given the "dearth of caselaw" on what constitutes a "security" under the New York version of Section 8-102(a)(15) of the New York U.C.C., and the manifest significance of the determination, we believe that certification to the New York Court of Appeals is appropriate. Accordingly, we certify the following question to the New York Court of Appeals:

> Based on this record, do the eight promissory notes issued by McNaughton Apparel Group, Inc. to the Schneiders fall within the definition of a "security" as contemplated by Section 8-102(a)(15) of the New York Uniform Commercial Code?

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[17] We also think it possible that resolution of the question whether the notes are securities may assist in our resolution of counts one and two of Highland's Third Amended Complaint. Accordingly, we reserve judgment on these two claims pending a response to the certified question by the New York Court of Appeals.

The New York Court of Appeals may, of course, reformulate or expand upon this question as it sees fit.

It is hereby Ordered that the Clerk of the Court transmit to the Clerk of the New York Court of Appeals a Certificate in the form attached, together with a copy of this opinion and a complete set of the briefs, appendices, and record filed by the parties in this Court. This panel will retain jurisdiction to decide the remaining issues – pertaining to counts one, two and seven of Highland's Third Amended Complaint – once we have receive an answer from the New York Court of Appeals, or once that court declines certification.

Finally, we order the parties to bear equally any fees and costs that may be requested by the New York Court of Appeals.

CERTIFICATION

The following question is hereby certified to the New York Court of Appeals pursuant to Second Circuit Local Rule § 0.27 and 22 N.Y.C.R.R. § 500.27, as ordered by the United States Court of Appeals for the Second Circuit:

> Based on this record, do the eight promissory notes issued by McNaughton Apparel Group, Inc., to the Schneiders fall within the definition of a "security" as contemplated by Section 8-102(a)(15) of the New York Uniform Commercial Code?

HIGHLAND CAPITAL MANAGEMENT, L.P.,
Plaintiff,
– against –
LEONARD SCHNEIDER,
LESLIE SCHNEIDER, SCOTT SCHNEIDER,
and SUSAN SCHNEIDER, Defendants.
LEONARD SCHNEIDER, LESLIE SCHNEIDER,
SCOTT SCHNEIDER, and SUSAN SCHNEIDER,
Third-Party Plaintiffs,
– against –
RBC CAPITAL MARKETS CORPORATION f/k/a/
RBC DOMINION SECURITIES CORPORATION,
Third-Party Defendant and
Third-Party Counterclaimant.

02 Civ. 8098 (PKL)

UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

2008 U.S. Dist. LEXIS 63874

August 20, 2008, Decided
August 20, 2008, Filed

COUNSEL: For Plaintiff: Paul B. Lackey, Esq., Jamie R. Welton, Esq., LACKEY HERSHMAN, L.L.P., Dallas, Texas.

For Defendants/Third-Party Plaintiffs: Alvin M. Stein, Esq., Katherine C. Ash, Esq., TROUTMAN SANDERS L.L.P., New York, New York.

For Third-Party Defendant/Third-Party Counterclaimant: Jack Yoskowitz, Esq., Michael J. McNamara, Esq., SEWARD & KISSEL L.L.P., New York, New York.

JUDGES: Peter K. Leisure, U.S.D.J.

OPINION BY: Peter K. Leisure

OPINION

OPINION AND ORDER

LEISURE, District Judges:

Following a jury trial on the merits, the Court entered judgment against defendants Leonard Schneider ("Leonard"), Leslie Schneider ("Leslie"), Scott Schneider ("Scott"), and Susan Schneider ("Susan") (collectively "defendants" or "the Schneiders") awarding damages to plaintiff Highland Capital Management, L.P. ("Highland") and third-party defendant and counterclaimant, RBC Capital Markets Corporation, formerly known as RBC Dominion Securities Corporation ("RBC").[1] Defendants now bring a motion for judgment as a matter of law, or in the alternative, for a new trial. The parties also request that the Court amend the judgment – plaintiffs bring a joint motion to correct the judgment and defendants bring a motion to alter or amend the judgment. For the following reason, defendants'

[1] Prior to the start of trial, the Court, after consulting with the parties, began referring to RBC as a "plaintiff" to avoid confusing the jury because only claims against the Schneiders remained after the Court's summary judgment decision. The Court will continue with this practice in this Order and Opinion. Thus, Highland and RBC are collectively referred to as "plaintiffs".

motions are DENIED and plaintiffs' motion is GRANTED.

BACKGROUND

Highland brought this action against defendants for their refusal to sell certain promissory notes (the "Notes"), valued at $ 69 million, to Highland and RBC. The factual background of this case is explained in detail in the Court's July 26, 2005 and January 16, 2008 summary judgment opinions, familiarity with which is assumed.[2] *See Highland Capital Mgmt., L.P. v. Schneider*, 533 F. Supp. 2d 345, 347-50 (S.D.N.Y. 2008); *Highland Capital Mgmt., L.P. v. Schneider*, No. 02 Civ. 8098, 2005 U.S. Dist. LEXIS 14912, 2005 WL 1765711, at *1-9 (S.D.N.Y. July 26, 2005). Any additional relevant facts are included in the discussion below.

Following this Court's determination of the parties' pre-trial motions, RBC's two remaining claims at trial were for (1) breach of duty to negotiate, and (2) breach of oral contract to sell the promissory notes. Both claims were premised upon the allegation that defendants, through their agent, Glen Rauch ("Rauch")

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[2] Following this Court's 2005 summary judgment opinion, the Second Circuit certified a question to the New York Court of Appeals and subsequently vacated and remanded this Court's judgment with respect to three of Highland's claims. *See Highland Capital Mgmt., L.P. v. Schneider*, 485 F.3d 690 (2d Cir. 2007); *Highland Capital Mgmt., L.P. v. Schneider*, 460 F.3d 308 (2d Cir. 2006); *see also Highland Capital Mgmt., L.P. v. Schneider*, 8 N.Y.3d 406, 834 N.Y.S.2d 692, 866 N.E.2d 1020 (2007).

or Glen Rauch Securities ("GRS"), entered into an agreement to sell the Notes to RBC. Additionally, Highland claimed that it was an intended third-party beneficiary of the purported contract between defendants and RBC.

Following a three-week trial, the jury returned a verdict in favor of plaintiffs on March 6, 2008. The Court's original judgment was entered on March 11, 2008 and an amended judgment, which corrected typographical errors and identified defendants by name, was entered on March 17, 2008 (collectively the "Judgment"). The Judgment awards $ 22,456,757.50 to Highland and $ 17,710,817.33 to RBC, as well as pre-judgment interest from June 19, 2001 through March 10, 2008.

On March 25, 2008, plaintiffs filed a joint motion to correct the judgment, which defendants oppose. On March 26, 2008, defendants filed a motion to alter or amend the judgment, as well as a motion for judgment as a matter of law, or in the alternative, for a new trial, which plaintiffs oppose.

DISCUSSION

I. *Defendants' Motion for Judgment as a Matter of Law, or in the Alternative, for a New Trial*

A. *Motion for Judgment as a Matter of Law*

1. *Standard Under Rule 50(b)*

Defendants move for judgment as a matter of law pursuant to Federal Rule of Civil Procedure 50(b).

The Court may properly grant a motion for judgment as a matter of law under Rule 50(b) "only if there is 'such a complete absence of evidence supporting the verdict that the jury's findings could only have been the result of sheer surmise and conjecture, or such an overwhelming amount of evidence in favor of the movant that reasonable and fair minded [persons] could not arrive at a verdict against [the moving party].'" *Stratton v. Dep't for the Aging for the City of New York*, 132 F.3d 869, 878 (2d Cir. 1997) (quoting *LeBlanc-Sternberg v. Fletcher*, 67 F.3d 412, 429 (2d Cir. 1995)); *see also Weissman v. Dawn Joy Fashions, Inc.*, 214 F.3d 224, 233 (2d Cir. 2000).

In ruling on a Rule 50(b) motion, the court is "required to 'consider the evidence in the light most favorable to the party against whom the motion was made and to give that party the benefit of all reasonable inferences that the jury might have drawn in his favor from the evidence. The court cannot assess the weight of conflicting evidence, pass on the credibility of the witnesses, or substitute its judgment for that of the jury.'" *LeBlanc-Sternberg*, 67 F.3d at 429 (quoting *Smith v. Lightning Bolt Prods., Inc.*, 861 F.2d 363, 367 (2d Cir. 1988)). "[W]hatever its own view of the facts may [be], the court [is] not entitled to substitute its view for adequately supported findings that were implicit in the jury's verdict." *Id.* at 430.

2. *Sufficiency of the Evidence*

The Court begins by rejecting defendants' arguments that they are entitled to judgment as a matter

of law because the jury's verdict was not supported by the evidence. The Court's review of the record indicates that there is substantial evidence in support of the verdict.

a. *Agreement to Sell the Notes*

Defendants argue that plaintiffs did not present sufficient evidence for "a reasonable jury determination that the Schneiders and RBC entered into an oral agreement for the sale of Notes." (Defs.' Memo. of Law at 11.) In support of their assertion, defendants cite testimony from Rauch and each of the defendants, as well as taped telephone conversations between Rauch and RBC. Defendants further contend that testimony presented by plaintiffs was inconsistent regarding the existence of a contract and RBC's failure to record the agreement.

Defendants have failed to demonstrate that the jury's finding that a contract existed was not adequately supported by evidence. Despite defendants' testimony in support of their position, their credibility was challenged more than once during the course of the trial. Such challenges included impeachment through the introduction of prior deposition testimony, as well as contradictory evidence presented by plaintiffs. Several of plaintiffs' witnesses, including Peter Parent ("Parent"), Ken Ambrecht ("Ambrecht"), and Max Holmes ("Holmes"), testified that an agreement was reached during an untaped telephone call on March 14, 2001. Plaintiffs presented additional

evidence in support of this testimony, such as evidence regarding RBC's actions following the agreement and Rauch's letter to Leonard regarding payment of a fee for his work on the transaction. Plaintiffs presented sufficient evidence that there was "a meeting of the minds, demonstrating the parties' mutual assent and mutual intent to be bound." *Oscar Prods., Inc. v. Zacharius*, 893 F. Supp. 250, 255 (S.D.N.Y. 1995). A reasonably jury could infer that defendants and RBC entered into an agreement for the sale of the Notes.

b. *Essential Terms*

Defendants contend that there was insufficient evidence of a meeting of the minds on essential terms of the agreement between defendants and RBC. Specifically, defendants argue that representations, warranties, and conditions were essential to the agreement. (Defs.' Memo. of Law at 14; Defs.' Reply at 25.) Defendants, however, have failed to show that there was a lack of evidence presented on this issue from which a reasonable jury could conclude that there was a meeting of the minds on essential terms. Plaintiffs presented witnesses, including Parent and Ambrecht, who testified that "size and price" were the only essential terms of this agreement. Based on the evidence, the jury could reasonable conclude that there was a meeting of the minds regarding all essential terms of the agreement. *See, e.g., Cinema N. Corp. v. Plaza at Latham Assocs. & Hoyt's Cinema*, 867 F.2d 135, 140 (2d Cir. 1989)

c. *Oral Agreement*

Defendants argue that the evidence demonstrated that "the parties intended that no agreement would be reached until it was reduced to a written agreement." (Defs.' Memo. of Law at 15.) The factors to be considered in determining whether the parties intended to be bound absent a written agreement are: "(1) whether there has been an express reservation of the right not to be bound in the absence of a writing; (2) whether there has been partial performance of the contract; (3) whether all of the terms of the alleged contract have been agreed upon; and (4) whether the agreement at issue is the type of contract that is usually committed to writing." *Winston v. Mediafare Entm't Corp.*, 777 F.2d 78, 80 (2d Cir. 1986). Defendants have failed to meet their burden of showing that no reasonable jury could find that a binding agreement to sell the Notes could be made orally.

Regarding the first factor, defendants contend that the January 5, 2001 Letter Agreement between GRS and Rac, along with evidence that RBC's representatives acknowledged that the transaction required a written agreement, precluded the jury from finding that there was an oral agreement. In reference to a possible resale of the Notes, the Letter Agreement between GRS and RBC states that "any such transaction is subject to definitive documentation in compliance with applicable law . . . " (Pls.' Exh. 20.) However, plaintiffs presented evidence that the Letter Agreement merely indicated that the trade would ultimately be documented, and not that

documentation was required to establish the agreement. Gerald A. Guild ("Guild"), plaintiffs' expert, testified regarding industry custom and practice, (Trial Tr. at 607:5-608:24), and Holmes, the drafter of the Letter Agreement, testified regarding his purpose for including the language and his interpretation of it. (Trial Tr. at 363:21-364:19.)

Defendants contend that the second factor also suggests that the parties did not intend to be bound absent a writing because there was no performance. (Defs.' Memo. of Law at 18.) Plantiffs, however, presented evidence from which the jury could reasonable conclude that RBC had partially performed under the agreement, including taking steps to complete the transaction as a riskless principal, such as hiring a lawyer. (Trial Tr. at 158:12-18.) Regarding the third factor, as discussed above, plaintiffs presented evidence that the parties had agreed on the essential terms of the contract. Finally, regarding the fourth factor, plaintiffs presented evidence, such as Guild's testimony, from which the jury could reasonably conclude that this was not the type of agreement that was usually committed to writing. (Trial Tr. at 607:10-608:24, 617:21-618:2.) Thus, there was sufficient evidence from which the jury could reasonably conclude that a binding agreement to sell the Notes could be made orally.

d. *Intended Third-Party Beneficiary*

Defendants assert that there was insufficient evidence to support Highland's claim as an intended

third-party beneficiary of the agreement between defendants and RBC. As the Court previously stated, "[i]n order to claim third party beneficiary status, [Highland] must allege: (1) the existence of a valid and binding contract between other parties, (2) that the contract was intended for [its] benefit and (3) that the benefit to [it] is sufficiently immediate, rather than incidental, to indicate the assumption by the contracting parties of a duty to compensate [it] if the benefit is lost." *Highland Capital Mgmt.*, 2005 U.S. Dist. LEXIS 14912, 2005 WL 1765711, at *19 (internal quotations omitted). An intended third-party beneficiary's identity need not be expressed in the agreement, but the parties to the contract must demonstrate their intention to benefit a third party in the agreement. *See McPheeters v. McGinn, Smith & Co., Inc.*, 953 F.2d 771, 773 (2d Cir. 1992); *Trans-Orient Marine Corp. v. Star. Trading & Marine, Inc.*, 925 F.2d 566, 573 (2d Cir. 1991); *In re Gulf Oil/Cities Serv. Tender Offer Litig.*, 725 F. Supp. 712, 733 (S.D.N.Y. 1989).

Defendants assert that Highland failed to present sufficient evidence to support the jury's finding that it was an intended third-party beneficiary. They claim that Highland presented no evidence that defendants and RBC recognized that the sale was to benefit a customer and that RBC actually sought to hide its agreement with Highland from defendants. (Defs.' Reply at 45-46.) Considering the record, a reasonable jury could conclude that Highland was an intended third-party beneficiary of the agreement

between defendants and RBC. Highland did not have to show that defendants knew Highland's identity, but only that the contract evidenced RBC's and defendants' intention to benefit a third party. Highland presented evidence that RBC was acting as a riskless principal and that Rauch was aware that RBC would immediately trade the Notes to a buyer.

e. *Agents' Authority*

Defendants contend that there was insufficient evidence to establish that Rauch had actual or apparent authority to bind defendants and that Leonard had actual or apparent authority to bind Leslie, Susan, or Scott. Actual authority is conferred, explicitly or impliedly, from the principal to the agent. *See Seetransport Wiking Trader Schiffarhtsgesellschaft MBH & Co. Kommanditgesellschaft v. Republic of Romania*, 123 F. Supp. 2d 174, 185-86 (S.D.N.Y. 2000) (Sprizzo, J.). An agent has apparent authority if "(1) [the] principal was responsible for the appearance of authority in the agent to conduct the transaction in question, and (2) the third party reasonably relied on the representations of the agent." *Highland Capital Mgmt.*, 2005 U.S. Dist. LEXIS 14912, 2005 WL 1765711, at *10 (internal quotations and citations omitted).

Defendants assert that plaintiffs presented no evidence that Rauch was authorized to sell the Notes on behalf of defendants and that he was, at most, authorized to negotiate on their behalf. (Defs.' Reply

at 32.) Defendants argue that the jury could not reasonably conclude that defendants created the appearance of authority when the Letter Agreement required that defendants approve any sale. (Defs.' Reply at 32-33.) They also claim that there was no evidence that defendants did anything to give the appearance to RBC that Rauch had the authority to enter into an agreement on their behalf. (Defs.' Reply at 35-36.)

Contrary to defendants' assertion, there was sufficient evidence that Rauch had authority to bind defendants. Plaintiffs presented evidence that the Letter Agreement did not exclude Rauch from having the authority to bind defendants. Additionally, they presented evidence demonstrating that it was industry custom and practice for brokers, like Rauch, to routinely enter into binding agreements on behalf of their clients. Plaintiffs presented evidence that Rauch, who was the family's broker for a number of years, considered bids, including "firm" offers, for the Notes on behalf of defendants in dealing with RBC. (Trial Tr. at 521:5-19, 525:4-7.) Indeed, there was evidence that defendants directed that RBC communicate with defendants only through Rauch. (Pls.' Exh. 50.) Thus, the jury reasonably concluded that Rauch had the authority to bind defendants to a sale of the Notes.

Similarly, plaintiffs presented sufficient evidence at trial for the jury reasonably to conclude that Leonard was the agent of Leslie, Susan, and Scott. Testimony from defendants and Rauch indicated that

Rauch routinely communicated with Leonard regarding trades for Leslie, Susan, and Scott. Regarding the Letter Agreement, Rauch stated that Leonard authorized him to sign on behalf of Leonard, Leslie, Susan, and Scott. (Trial Tr. at 499:4-7.) Rauch also stated that Leonard "usually spoke for his children." (Trial Tr. at 491:10.) Additionally, attorney James Alterbaum represented all defendant's and approved the Letter Agreement. Finally, plaintiffs introduced Leonard's deposition testimony to impeach his testimony at trial on this issue. Therefore, plaintiffs put forth sufficient evidence for the jury to find that Rauch had authority to bind defendants and that Leonard had authority to bind Leslie, Susan, and Scott.

In light of the record, the Court finds that the jury's verdict was supported by substantial evidence and defendants' motion for judgment as a matter of law must be denied.

B. *Motion for a New Trial*

"In ruling on a Rule 59 motion a court makes the same type of inquiry as on a motion for judgment as a matter of law, but imposes a less stringent standard." *Fowler v. New York Transit Auth.*, No. 96 Civ. 6796, 2001 U.S. Dist. LEXIS 762, 2001 WL 83228, *2 (S.D.N.Y. 2001) (citing *Katara v. D.E. Jones Commodities, Inc.*, 835 F.2d 966, 970 (2d Cir. 1987); *Newmont Mines Ltd. v. Hanover Ins. Co.*, 784 F.2d 127, 132 (2d Cir.. 1986)). "The decision whether to grant a new

trial on the ground that the verdict was against the weight of the evidence is committed to the sound discretion of the district court." *U.S. E. Telecomms., Inc. v. U.S. W. Commc'ns Servs., Inc.*, 38 F.3d 1289, 1301 (2d Cir. 1994) (internal quotations and citation omitted). In exercising its discretion, "[a] trial court should grant such a motion when convinced that the jury has reached a seriously erroneous result or the verdict is a miscarriage of justice," *Katara*, 835 F.2d at 970, or the verdict is "against the weight of the evidence." *U.S. E. Telecomms., Inc.*, 38 F.3d at 1301. "While the Court need not necessarily weigh the evidence in. the light most favorable to the non-moving party, disagreement with the verdict alone is insufficient to justify ordering a new trial." *Muller v. Costello*, 997 F. Supp. 299, 302 (N.D.N.Y. 1998) (citing *Mallis v. Bankers Trust Co.*, 717 F.2d 683, 688-89 (2d Cir. 1983)).

1. *Damages*

In support of their motion for a new trial, defendants make various challenges to the damages awards, claiming that the damages were inconsistent with controlling law, unsupported by evidence, the result of errors in the jury charge, and clearly excessive. (Defs.' Memo. of Law at 28.)

a. *General Damages Award*

First, the Court addresses defendants' argument that the general damages award was contrary to

controlling law and not supported by the evidence. Damages for breach of contract should place the aggrieved party in the same economic position it would have been in had the breaching party fully performed. *See Commerce Funding Corp. v. Comprehensive Habilitation Servs., Inc.*, No. 01 Civ. 3796, 2005 U.S. Dist. LEXIS 2832, 2005 WL 447377, at *18 (S.D.N.Y. Feb. 24, 2005) (Leisure, J.); *see also Contemporary Mission, Inc. v. Bonded Mailings, Inc.*, 671 F.2d 81, 84 (2d Cir. 1982). A plaintiff need not prove damages with mathematical precision, but must demonstrate damages with reasonable certainty. *See, e.g., Exodus Partners, LLC v. Cooke*, No. 04 Civ. 10239, 2007 U.S. Dist. LEXIS 3544, 2007 WL 120053, at *14 (S.D.N.Y. Jan. 16, 2007). In this case, the jury was asked to "calculate damages by determining' the difference between the contract price for the Notes that the parties agreed to and the value of the Notes at the time of the breach." (Jury Charge at 55.)

Defendants contend that the jury's damages award improperly takes into account post-breach events; specifically, the Jones-McNaughton merger and the subsequent payment on the Notes at face value to defendants.[3] Defendants also argue that the

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[3] There was evidence presented at trial that in March 2001 defendants obtained material nonpublic information regarding a potential deal between the issuer of the Notes, McNaughton Apparel Group, Inc., formerly known as Norton McNaughton, Inc. ("McNaughton") and Jones Apparel Group ("Jones"). On April 16, 2001, it was publicly announced that Jones had agreed to purchase McNaughton. The Notes were paid out in full on

(Continued on following page)

only evidence of market value at the time of the breach was Highland's 52.5 cent offer to RBC. Defendants contend that any material nonpublic information that they possessed at the time of the breach was uncertain and should have no bearing on the Notes' market value.

Assessing damages is a factual inquiry for the jury. *See Ismail v. Cohen*, 899 F.2d 183, 186 (2d Cir. 1990) ("It is well settled that calculation of damages is the province of the jury."). Here, there was sufficient evidence for the jury to conclude that the value of the Notes at the time of the breach was the full face value. The jury could reasonably conclude that the material nonpublic information possessed by defendants impacted the value of the Notes at the time of the breach. Similarly, a reasonable jury calculating damages could conclude that it was irrelevant that the individuals who were actually negotiating the agreement did not possess this material nonpublic information. (Defs.' Reply at 12.) The jury's general damages award is supported by law and the evidence presented at trial, and provides reasonable compensation for defendants' breach.

b. *Jury Charge*

Defendants contend that the Court's failure to include certain of their proposed jury instructions

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June 19, 2001, with defendants receiving $ 69 million plus interest.

allowed the jury to incorrectly calculate damages, resulting in substantial error. The Court is granted discretion in the wording of jury instructions, "so long as the instructions, taken as a whole, do not mislead the jury as to the proper legal standard, or . . . adequately inform the jury of the law." *See Parker v. Sony Pictures Entm't, Inc.*, 260 F.3d 100, 106-07 (2d Cir. 2001) (internal quotations omitted). "A jury instruction is erroneous if the instruction misleads the jury as to the proper legal standard, or it does not adequately inform the jury of the law, but such an error will not be grounds for reversal unless taken as a whole, the jury instructions gave a misleading impression or inadequate understanding of the law." *Owen v. Thermatool Corp.*, 155 F.3d 137, 139 (2d Cir. 1998) (internal quotations omitted). The jury was instructed to calculate damages at the time of the breach, based on the difference between the contract price and the value of the notes at the time of the breach. Considering the charge as a whole, the Court's wording adequately informed the jury of the law and was not misleading.

c. *Benefit of the Bargain Damages*

Defendants argue that the jury improperly awarded damages to RBC for Leonard's $ 23.6 million Note, which was to be sold to Fidelity. In ruling on the parties' motions in limine, the Court held that RBC could not assert a claim on behalf of Fidelity. *See Highland Capital Mgmt., L.P. v. Schneider*, 551 F. Supp. 2d 173, 194-95 (S.D.N.Y. 2008) (Leisure, J.).

The jury's award here, however, is not in contravention of the Court's *in limine* ruling. RBC's breach of contract claim was for the full $ 69 million of Notes, which was separate from any claims brought by third parties like Highland and Fidelity. Thus, the jury's award was not erroneous.

d. *Consequential Damages*

In addition to general damages, the jury awarded RBC $ 5 million in consequential damages for lost profits stemming from defendants' breach. Defendants assert that the award of consequential damages was contrary to law because "there was no evidence from which the jury could rationally have found that the loss of future Fidelity business, or the loss of profits from any such future business, was within the contemplation of the Schneiders (or Rauch) at the time that the alleged oral agreement was made." (Defs.' Memo. of Law at 43.) Additionally, defendants claim that RBC failed to prove consequential damages with sufficient certainty.

"[A] party may recover lost profits if (1) its alleged lost profits were caused by the breach; (2) the 'damages were fairly within the contemplation of the parties' when contracting; and (3) the damages can be proven with a reasonable certainty." *Merlite Indus., Inc. v. Valassis Inserts, Inc.*, 12 F.3d 373, 376 (2d Cir. 1993) (quoting *Kenford Co. v. County of Erie*, 67 N.Y.2d 257, 261, 493 N.E.2d 234, 502 N.Y.S.2d 131, 132 (1986)).

The jury's award of consequential damages was supported by the evidence and was not contrary to law. First, RBC presented evidence at trial for the jury to reasonably conclude that RBC's lost profits were caused by defendants' breach. Such evidence included taped telephone conversations between personnel for RBC and Fidelity, as well as testimony from RBC's Parent and Highland's Mark Okada, which indicated that Fidelity and Highland ceased doing business with RBC as a result of RBC's failure to deliver defendants' Notes. Second, RBC presented evidence for the jury reasonably to conclude that lost profits were within the contemplation of the parties when the agreement was made. RBC presented evidence, such as taped telephone conversations and testimony regarding Rauch's experience in the industry, from which the jury could reasonably conclude that Rauch, acting as defendants' agent, knew RBC would be selling defendants' Notes to a third party and that such lost profits were a foreseeable consequence of defendants' breach. Third, the jury could rationally conclude that RBC proved lost profits damages with reasonable certainty. Expert witness Guild testified extensively on this topic and discussed his calculation of lost profits based on transactions between RBC and Fidelity, and RBC and Highland. 'Thus, the jury's award of consequential damages for lost profits was not contrary to law, was supported by evidence, and is not grounds for a new trial.

c. *RBC-Rauch Settlement*

RBC filed a National Association of Securities Dealers, Inc. ("NASD") arbitration Statement of Claim against GRS in March 2003, asserting claims arising out of the role of GRS and Rauch in selling defendants' Notes to RBC. RBC and GRS settled the dispute prior to an arbitration hearing being held. Prior to trial, defendants moved to compel production of the settlement agreement. Magistrate Judge Gorenstein denied that request under Federal Rule of Civil Procedure 26(b)(1), in an Order dated September 28, 2007, indicating that consideration of the request, as it relates to any reduction in RBC's damages, would be more appropriate following trial. *See Highland Capital Mgmt., L.P. v. Schneider et al.*, No. 02 Civ. 8098, 2007 U.S. Dist. LEXIS 97453 at *8 (S.D.N.Y. Sept. 28, 2007) (Gorenstein, N.J.). RBC filed a motion *in limine* to exclude defendants from offering any evidence, testimony, argument, or reference at trial regarding the NASD arbitration or the settlement with GRS. The Court granted RBC's motion and defendants were precluded from offering evidence, testimony, argument, or reference to the arbitration and subsequent settlement.

Now, defendants ask the Court to direct RBC "to produce the settlement agreement or disclose the amount of the settlement, and the amount paid by Rauch must be subtracted from RBC's judgment. . . ." (Defs.' Memo. of Law at 49.) In opposition, RBC argues that because this issue was not raised by defendants at trial, it is improperly raised in

defendants' post-trial motion. (RBC Opp. at 42 n.21.) RBC's assertion is unfounded. Defendants repeatedly raised the arbitration and settlement issue before trial. In his Order, Magistrate Judge Gorenstein stated that "[c]ases considering such an argument have typically determined that the settlement amount should be disclosed only following trial, and we follow that same approach here." *Highland Capital Mgmt.*, 2007 U.S. Dist. LEXIS 97453 at *8. Therefore, the Court must consider whether RBC should be directed to produce the settlement agreement or amount and whether to subtract that amount from RBC's judgment.

Defendants fail to provide any legal support for their assertion that "the damages awarded to RBC must be reduced by the amount of the GRS-RBC settlement." (Defs.' Reply at 19.) Courts have noted that section 15-108 of New York's General Obligations Law ("GOL") may permit disclosure, after trial, to a non-settling defendant of a settlement amount between plaintiff and a settling party. *See ABF Capital Mgmt. v. Askin Capital*, No. 96 Civ. 2978, 2000 U.S. Dist. LEXIS 3633, 2000 WL 191698, at *3 (S.D.N.Y. Feb. 8, 2000). Section 15-108, however, applies only in tort actions. *See, e.g., Bauman v. Garfinkle*, 235 A.D.2d 245, 245, 652 N.Y.S.2d 32, 33 (1st Dep't 1997) (citing *Bankers Trust Co. v. Lee Keeling & Assocs. Inc.*, 20 F.3d 1092, 1099 (10th Cir. 1994) (applying New York law)). At trial, plaintiffs only asserted contract claims. Accordingly, section 15-108 does not apply here.

GRS and Rauch were never parties in this action. The jury found that defendants were liable to plaintiffs for certain damages. Although Rauch acted as defendants' agent, his own liability was never before the jury and there was no finding that he breached any obligation to plaintiffs on his own behalf. Further, Magistrate Judge Gorenstein, after reviewing the settlement agreement in camera, stated that it includes "no admissions of liability or any other material relating to the merits of the dispute." *Highland Capital Mgmt.*, 551 F. Supp. 2d at 199. The settlement between RBC and GRS is separate from the jury's award and has no bearing on RBC's damages in this action. Defendants' request to have the Court direct RBC to disclose the settlement agreement or, amount is denied.

2. *Substantial Errors Arguments*

Defendants also assert that the Court committed substantial errors which require the Court to grant a new trial. Defendants take issue with the jury charge, the verdict form, and certain evidentiary rulings. (Defs.' Memo. of Law at 50.)

a. *Jury Charge*

Defendants contend that a new trial is required because the Court failed to instruct the jury properly on the law regarding oral agreements. Specially, defendants argue that the Court's instructions were improper on the following subjects: plaintiffs' burden

to prove the existence of a binding oral agreement; defendants' intent to be bound absent a writing; the instruction that "an oral agreement for the sale of securities is binding and enforceable under New York law" made the charge confusing and incorrect; and the Court provided little guidance on the factors for the jury to consider whether there was a binding oral agreement.

The Court properly instructed the jury that plaintiffs "must show that there was a meeting of the minds between Rauch and RBC on the essential terms of the contract, demonstrating mutual assent and a mutual intent to be bound." (Jury Charge at 40, 45.) Because it is the law of the case that the Notes at issue are securities, *Highland Capital Mgmt., L.P. v. Schneider*, 8 N.Y.3d 406, 834 N.Y.S.2d 692, 866 N.E.2d 1020 (2007), the Court properly instructed the jury regarding oral agreements for the sale of securities. The Court adequately instructed the jury regarding whether a party intends to be bound absent a writing by stating that "if the parties contemplate a formal written contract and that they will not be bound until such contract is signed, there is no binding agreement absent such contract." (Jury Charge at 40-41.) Although the Court did not enumerate the four *Winston* factors in the instructions on breach of contract, but did so in the instructions on breach of a preliminary agreement, the instructions, taken as a whole, properly instructed the jury on how to determine whether an oral agreement had been reached. Further, there was no indication that the jury was

confused by the instructions; the jury's only note during deliberations was a request for a copy of the entire jury charge. In sum, the Court's instructions were neither unclear nor incorrect as a matter of law.[4]

b. *Verdict Form*

Defendants argue that the verdict form was deficient, asserting that it was "doomed to confuse the jury" because the form did not ask the jury to decide whether each defendant had entered into a binding agreement to sell Notes. The verdict form asked the jury: "Do you find that plaintiff RBC is entitled to recover damages from defendants for breach of contract?" The form then listed each of the defendants by name and provided a space for the jury to check "yes" or "no". Similar language and a similar format were used with respect to Highland's claim as well.

The jury was provided the verdict form only after the Court's extensive instructions. The Jury Charge and the verdict form required the jury to consider numerous hurdles, including whether each defendant

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[4] Defendants also argue that the jury charge was erroneous because it declined to include defendants' proposed language regarding objective manifestation of the parties' intent to be bound to a contract. (Defs.' Memo. of Law at 62.) The Court's instruction that RBC was required to prove that the parties had "a meeting of the minds" on essential terms and demonstrated "mutual assent and mutual intent to be bound" was a proper recitation of the law and was not substantial error. (Jury Charge at 40, 45.)

had entered into a binding agreement, whether each defendant had breached that agreement, and whether plaintiffs were entitled to recover damages for that breach. There was no indication that the jury was confused by the instructions or the verdict form. The Court properly exercised its discretion in choosing the wording of the verdict form. The verdict form was sufficient; therefore defendants' argument does not support granting a new trial.

c. *Admission of Evidence*

At trial, the jury heard recordings of numerous telephone calls, which had been recorded by RBC in its regular course of business. There were conversations between RBC employees and Rauch, RBC employees and Highland employees, RBC employees and Fidelity employees, and among RBC employees. Prior to trial, defendants sought a ruling excluding all taped conversations between Highland and RBC, between Fidelity and RBC, and amongst RBC employees (hereinafter referred to as the "non-Rauch recordings"). Defendants argued that whatever RBC personnel told a fellow employee, Highland, or Fidelity was not relevant or attributable to defendants. The Court denied that motion, without prejudice for renewal at trial. However, the Court stated that, generally, the non-Rauch recordings were relevant under Federal Rule of Evidence 401. At various times during the trial when non-Rauch recordings were played for the jury, the Court issued a limiting instruction.

Defendants now argue that a new trial is warranted because the Court committed substantial error in admitting the non-Rauch recordings, which they assert were irrelevant hearsay. Defendants argue that the Court's *in limine* ruling was erroneous, that the state of mind exception to the hearsay rule did not apply here, and that the Court's limiting instruction did not cure the prejudice that defendants suffered. In order to warrant a new trial, the introduction of inadmissible evidence must have been a clear abuse of discretion and so clearly prejudicial to the outcome of the trial that the result was seriously erroneous or a miscarriage of justice. *See SR Int'l Bus. Ins. Co., Ltd. v. World Trade Ctr. Props., LLC*, 467 F.3d 107, 119 (2d Cir. 2006); *Nimely v. City of New York*, 414 F.3d 381, 399-400 (2d Cir. 2005); *Perry v. Ethan Allen, Inc.*, 115 F.3d 143, 150 (2d Cir. 1997).[5]

As the Court stated in its *in limine* decision and numerous times at trial, the non-Rauch recordings were not admissible for the truth of the matter asserted, but rather, were admissible "only insofar as it

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[5] Defendants also assert that plaintiffs' counsels' use of the phrase "material nonpublic information" forty-five times during the trial was unfairly prejudicial to defendants. (Defs.' Memo. of Law at 61 n.21; Defs.' Reply at 44.) The Court refers to its *in limine* ruling, which adequately addressed defendants' concerns about prejudice from being unfairly portrayed as "bad people" by substantially limiting the language that could be used. *See Highland Capital Mgmt.*, 551 F. Supp. 2d at 191-93. The Court properly allowed plaintiffs to use the phrase "material nonpublic information" and defendants were not unfairly prejudiced by plaintiffs' use of it.

may reflect on the state of mind of either the speaker or the listener." (Trial Tr. at 137:25-138:2.) Federal Rule of Evidence 803(3) states:

> Then existing mental, emotional, or physical condition. A statement of the declarant's then existing state of mind, emotion, sensation, or physical condition (such as intent, plan, motive, design, mental feeling, pain, and bodily health), but not including a statement of memory or belief to prove the fact remembered or believed unless it relates to the execution, revocation, identification, or terms of declarant's will.

Here, the non-Rauch recordings include statements "of the declarant's then existing state of mind," *id.*, regarding the sale of defendants' Notes. The recordings occurred while the negotiations were proceeding, thus capturing the speakers' state of mind during the relevant period.[6]

Additionally, the non-Rauch recordings were relevant. "'Relevant evidence' means evidence having any tendency to make the existence of any fact that is of consequence to the determination of the action more or less probable than it would be without the

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[6] Highland contends that the non-Rauch recordings are not hearsay because they are business records under Federal Rule of Evidence 803(6). (Highland Opp. at 37.) As the Court stated at trial, however, even if the recordings could be considered business records, there still could be a hearsay-within-hearsay problem rendering them inadmissible.

evidence." Fed. R. Evid. 401. Although the non-Rauch recordings were not direct evidence of whether defendants agreed to sell their Notes, (Defs.' Reply at 41), the recordings were relevant to plaintiffs' claims under the Rule 401 standard. The recordings reflected the state of mind of the key personnel in the negotiations in the moments leading up to and following the transaction that gave rise to this action.

Under Federal Rule of Evidence 403, relevant evidence may be excluded where "its probative value is substantially outweighed by the danger of unfair prejudice." Evidence is prejudicial under Rule 403 if it "involves 'some adverse effect . . . beyond tending to prove the fact or issue that justified its admission into evidence.'" *United States v. Gelzer*, 50 F.3d 1133, 1139 (2d Cir. 1995) (quoting *United States v. Figueroa*, 618 F.2d 934, 943 (2d Cir. 1980)). Such evidence will be excluded if it has "an undue tendency to suggest decision on an improper basis, commonly, though not necessarily, an emotional one." Fed. R. Evid. 403, advisory committee's notes. Here, the probative value of the non-Rauch recordings substantially outweighed any danger of unfair prejudice to defendants. The evidence was relevant and useful to the jury in understanding the circumstances of the transaction, as well as plaintiffs' state of mind at the time of the transaction. This is particularly so where the recordings were made at the time of the transaction and the trial did not occur until seven years later.

As previously noted, during the trial, the Court issued a limiting instruction to the jury regarding

evidence admitted under the state of mind exception to the hearsay rule, stating that it may only be considered as evidence of the state of mind of the speaker or listener. In addition to repeating the instruction at appropriate times during the trial, the Court included the limiting instruction in its Jury Charge. During the testimony of the first witness in which the issue arose, the Court informed the jury that defendants' counsel "has a standing objection with respect to the testimony of this witness, and he may well renew it with respect to others." (Trial Tr. at 137:16-18.) There is a presumption that a jury follows such limiting instructions. *See United States v. Downing*, 297 F.3d 52, 59 (2d Cir. 2002) ("Absent evidence to the contrary, we must presume that juries understand and abide by a district court's limiting instructions.") (citing *Zafiro v. United States*, 506 U.S. 534, 540-41, 113 S. Ct. 933, 122 L. Ed. 2d 317, (1993)). The instruction cured any potential unfair prejudice that defendants might have suffered.

d. *Holmes*

Defendants sought to make reference to Judge Cabranes's 1991 opinion in *S.N. Phelps & Co. v. Prudential Insurance Co.*, No. 91 Civ. 00451 (D. Conn. 1991), a case which involved RBC's Max Holmes and his previous employer, Prudential Insurance Co. Defendants intended to ask questions of Holmes regarding his involvement in and understanding of that action, believing it had some bearing on his intent in drafting the January 5, 2001

Letter Agreement in this case. The Court excluded any reference to *Phelps* at trial.

Defendants now assert that the Court's exclusion of such evidence was in error and that a new trial is warranted. The Court, however, properly excluded evidence relating to *Phelps*. Judge Cabranes's *Phelps* decision was inadmissible hearsay. *See Blue Cross and Blue Shield of New Jersey, Inc. v. Philip Morris, Inc.*, 141 F. Supp. 2d 320, 323 (E.D.N.Y. 2001) ("Judicial findings in other cases proffered as evidence are generally characterized as inadmissable hearsay."); *cf. Torah Soft Ltd. v. Drosnin*, No. 00 Civ. 0676, 2003 U.S. Dist. LEXIS 16273, 2003 WL 22024074, at *1-2 (S.D.N.Y. Aug. 28, 2003) (holding that where a prior judicial opinion in a related action may have preclusive effects, the opinion may be admissible evidence). Even if such evidence could fall under a hearsay exception, an opinion from another jurisdiction, in a case between different parties, from many years prior, and when the witness was with a different employer, was not relevant in this action under Federal Rule of Evidence 401. Furthermore, under the Federal Rule of Evidence 403 balancing test, any reference to *Phelps* would have been substantially more prejudicial than probative. The risk of unfair prejudice was high because the jury may have given undue weight to any reference by defendants to *Phelps* or Holmes's involvement in *Phelps*. Additionally, reference to *Phelps* in any way was likely to cause juror confusion. The Court also notes that defendants were granted the opportunity to cross-examine

Holmes and thereby challenge his credibility and inquire as to his intent in drafting the Letter Agreement Even if the Court's ruling was error, it certainly was not substantial error warranting a new trial. Accordingly, the Court rejects defendants' argument that a new trial is warranted on this basis.

e. *Guild*

Guild testified as an expert witness for plaintiffs. Defendants now assert that the Court's admission of Guild's testimony on custom and practice in the securities industry was material error. The Court ruled on the admissibility of Guild's testimony in its January 31, 2008 decision on the parties' numerous motions *in limine*. *See Highland Capital Mgmt.*, 551 F. Supp. 2d at 182-83. The Court held that Guild was qualified to testify as an expert and permitted him to testify on industry custom and practice, finding it relevant to the case and potentially helpful to the jury. The Court did place limits on Guild's testimony, ruling that he could not testify regarding an individual's state of mind or credibility, and that he could not testify as to ultimate legal conclusions. *Id.*

The admission of industry custom and practice testimony in a securities action is not uncommon. *See, e.g., United States v. Bilzerian*, 926 F.2d 1285, 1294 (2d Cir. 1991) ("Particularly in complex cases involving the securities industry, expert testimony may help a jury understand unfamiliar terms and concepts."); *S.E.C. v. Lorin*, 877 F. Supp. 192, 196

(S.D.N.Y. 1995), *modified*, 76 F.3d 458 (2d Cir. 1996); *Marx & Co., Inc. v. Diners' Club, Inc.*, 550 F.2d 505, 511 (2d Cir. 1977), *cert. denied*, 434 U.S. 861, 98 S. Ct. 188, 54 L. Ed. 2d 134 (1977). Although defendants' Notes were "unusual" and their sale was not like a typical public security trade, industry custom and practice has proven relevant to this case as it progressed through this Court, the Second Circuit, and the New York Court of Appeals. As in other cases involving securities, such testimony aided the jury in understanding the issues before them.

Guided by the Court's *in limine* decision, Guild limited his testimony and did not draw legal conclusions. Rather, he testified regarding factors indicating to him, as an expert, whether there was an oral agreement and whether Rauch was defendants' agent. *See In re Blech Secs. Litig.*, No. 94 Civ. 7696, 2003 U.S. Dist. LEXIS 4650, 2003 WL 1610775, at *22-23 (S.D.N.Y. Mar. 26, 2003) (Sweet, J.). Additionally, defendants' assertion that Guild's industry custom and practice testimony should not have been permitted because defendants themselves were not members, of the security industry is unfounded. The jury concluded that Rauch, a broker in the securities industry, was acting as defendants' agent in the sale of these securities. Defendants also were granted the opportunity to present their own expert witness on these same issues, with the same limitations. Finally, the Court instructed the jury regarding the role of expert testimony. (*See, e.g.*, Trial Tr. at 610:9-612:23.)

f. *Actual and Apparent Authority*

Defendants-assert that the Court's instructions on actual and apparent authority were erroneous and warrant a new trial. Defendants contend that the Court erred by instructing the jury on actual authority, claiming that there was no evidence of it at trial. They also argue that the Court erred in including an instruction on implied actual authority, and that the erroneously included instruction was incomplete. Additionally, defendants claim that the Court's instructions on apparent authority were misstated and gave the jury a false impression of Rauch's authority. Finally, defendants argue that the Court failed to explain that the jury needed to find two levels of agency for the claims against Susan, Leslie, and Scott.

The Court's charge on actual and apparent authority was consistent with New York law and, as a whole, adequately instructed the jury on the law. Plaintiffs presented some evidence that Rauch possessed actual authority to bind defendants to a sale of their Notes; therefore, an instruction on actual authority was appropriate. *See, e.g., Hilord Chem. Corp. v. Ricoh Elecs., Inc.*, 875 F.2d 32, 38 (2d Cir. 1989) ("All that is necessary is that there be some evidence supporting a party's theory of the case.") (citing *Doyle v. Exxon Corp.*, 592 F.2d 44, 47 (2d Cir. 1979)). Further, the Court's instruction that "[i]f an agent has implied actual authority, the agent is authorized to act in a manner in which the act is ordinarily performed or which is inherent or incidental to the

ordinary scope of authority associated with the agent's position, unless the principal informs the third party of a specific limitation on the agent's authority," (Jury Charge at 35), was an adequate statement of the law.

In addition, the Court's instruction on apparent authority was not erroneous. The Court properly exercised its discretion in denying defendants' request to include additional language regarding apparent authority in this particular case. The Court did not convey to the jury any false impressions, as defendants' claim, but instead, allowed the jury to perform its fact-finding role.

Contrary to defendants' assertion, the Court did instruct the jury regarding whether Rauch was an agent for each defendant and whether Leonard was an agent for Leslie, Susan, or Scott. Indeed, the Court instructed the jury that they "should apply these [agency] principals to the facts of this case in determining whether or not Glen Rauch was an agent of the Schneiders with the authority to sell the notes at issue, or whether or not Leonard Schneider was an agent of his children with the authority to hire and direct Rauch to negotiate and sell on behalf of the Schneiders." (Jury Charge at 33.) This instruction, taken together with the rest of the charge, was not confusing or misleading.

In sum, the jury's findings were well supported by the evidence at trial, and the Court did not commit substantial errors warranting a new trial. The Court

cannot say that the jury's verdict is against the weight of the evidence or that the jury reached a seriously erroneous result. Therefore, defendant's motion for a new trial is denied.

II. *Amendment of the Judgment*

All parties request that the Court amend the Judgment. Plaintiffs bring a joint motion to correct the judgment pursuant to Rule 60(a) of the Federal Rules of Civil Procedure and defendants bring a motion to alter or amend the judgment pursuant to Rule 59(e) of the Federal Rules of Civil Procedure. For the following reasons, plaintiffs' motion is granted and defendants' motion is denied.

A. *Federal Rules of Civil Procedure 59(e) and 60(a)*

Federal Rule of Civil Procedure 59(e) provides that "[a] motion to alter or amend a judgment must be filed no later than 10 days after the entry of the judgment." A motion to amend a judgment pursuant to Rule 59(e) properly is granted where the movant demonstrates that the judgment is based upon manifest errors of law or fact. *See, e.g., Davidcraft Corp. v. Danu Int'l, Inc.*, No. 90 Civ. 6578, 1992 U.S. Dist. LEXIS 13845, 1992 WL 247035, at *1 (S.D.N.Y. Sept. 15, 1992); *Wallace v. Brown*, 485 F. Supp. 77, 79 (S.D.N.Y. 1979).

Federal Rule of Civil Procedure 60(a) provides that "[t]he court may correct a clerical mistake or a

mistake arising from oversight or omission whenever one is found in a judgment, order, or other part of the record. The court may do so on motion or on its own, with or without notice." The "general purpose of Rule 60(a) 'is to afford courts a means of modifying their judgments in order to ensure that the record reflects the actual intentions of the court.'" *Slupinski v. First Unum Life Ins. Co.*, No. 99 Civ. 0616, 2006 U.S. Dist. LEXIS 55545, 2006 WL 2266569, at *2 (S.D.N.Y. Aug. 7, 2006) (quoting *Employers Mut. Casualty Co. v. Key Pharms.*, 886 F. Supp. 360, 363 (S.D.N.Y. 1995)). Thus, Rule 60(a) "permits the correction not only of clerical mistakes, but also of inadvertent errors arising from oversight or omission." *In re Marc Rich & Co. A.G.*, 739 F.2d 834, 836 (2d Cir. 1984) (internal quotations omitted).

B. *Damages Awards*

1. *General Damages*

The parties agree that the Judgment should be amended to reflect that defendants' liability for general damages should have been several, and not joint. (Pls.' Amend. Memo. of Law at 3; Defs:' Amend. Opp. at 3.) The parties also agree to the apportionment of general damages to each defendant based on the amount of his or her notes. (Defs.' Amend. Opp. at 10-11.) However, the parties disagree as to whether the amendment should be made pursuant to Rule 59(e) or Rule 60(a).

The Court holds that because an amendment of the general damages here involves correction of only "clerical mistakes" or "inadvertent errors," *In re Marc Rich & Co. A.G.*, 739 F.2d at 836, and not "manifest errors of law or fact," *Bowers v. Andrew Weir Shipping, Ltd.*, 817 F. Supp. 4, 5 (S.D.N.Y. 1993) (Leisure, J.), the Court shall amend the Judgment pursuant to Rule 60(a). The amendment "is a type of mistake or omission mechanical in nature which is apparent on the record and which does not involve a legal decision or judgment by an attorney." *Hegger v. Green*, 91 F.R.D. 595, 597 (S.D.N.Y. 1981) (internal quotations omitted). Here, the intent of the Court was clear.[7] *See Robert Lewis Rosen Assocs., Ltd. v. Webb*, 473 F.3d 498, 503-04 (2d Cir. 2007). Accordingly, the Judgment shall be amended to indicate that defendants are severally liable for general damages in the following amounts. Highland is awarded damages of $ 3,173,974.33 from Leonard, $ 13,155,659.68 from Leslie, $ 13,155,659.68 from Susan, and $ 6,571,030.05 from Scott. RBC is awarded damages of $ 19,411,278.21 from Leonard, $ 368,828.32 from Leslie, $ 368,828.32 from Susan, and $ 199,414.16 from Scott.

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[7] The jury's benefit of the bargain damages award was based on the face value of defendants' eight promissory notes less the amount plaintiffs would have paid for the notes, plus interim interest. (Pls.' Memo. of Law at 3-4.) The jury's award plainly was based on each defendant's breach with respect to his or her individual notes.

2. *Consequential Damages*

The jury awarded $ 5 million in consequential damages to RBC. With pre-judgment interest of $ 3,027,945.20, defendants are jointly liable for $ 8,027,945.20 in consequential damages to RBC under the Judgment. The parties dispute whether defendants should be jointly liable for the consequential damages. Defendants assert that, if the Court deems the Judgment correctable,[8] only Leonard should be liable for consequential damages because most or all of the consequential damages award was based on lost business from Fidelity.[9] (Defs.' Amend. Opp. at 12-13.) Defendants assert that "[t]he most reasonable way to amend the judgment would be to attribute the consequential damages to the source of what is very probably over 98% of them, by making only Leonard Schneider individually liable for those damages." (Defs.' Amend. Reply at 5.) RBC contends that defendants should be jointly liable for consequential damages because RBC put forth evidence of lost business profits from both Fidelity and Highland, and defendants have failed to show why the lost

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[8] Defendants' primary argument is that there is an insufficient basis for awarding consequential damages; however, in light of the Court's decision above denying defendants' motion for judgment as a matter of law, or in the alternative, for a new trial, the Court considers defendants' secondary argument here.

[9] Leonard's breach of his obligation to deliver his $ 23.6 million promissory note was the source of RBC's lost business damages from Fidelity. (Defs.' Amend. Opp. at 5.)

business damages should be attributed only to Leonard. (BBC's Amend. Reply at 3-9.)

The parties' dispute focuses on the question of whether the jury's award of consequential damages included lost business solely from Fidelity or from Highland as well. As defendants admit, "[i]t is impossible to answer this question with certainty. . . ." (Defs.' Amend. Reply at 4-5.) Defendants further acknowledge that "the jury's consequential damages award cannot be parsed with precision." (*Id.* at 5.) The jury did not adopt the consequential damages figures set forth by RBC during the trial.[10] Defendants have failed to demonstrate that the jury's actual intentions were not reflected in the Judgment. *See Employers Mut. Casualty Co.*, 886 F. Supp. at 363. Thus, the Court finds no basis for disturbing the consequential damages award in the Judgment.

3. *Post-Judgment Interest*

Under 28 U.S.C. § 1961(a), "interest shall be calculated from the date of the entry of the judgment, at a rate equal to the weekly average 1-year constant maturity Treasury yield, as published by the Board of Governors of the Federal Reserve System, for the calendar week preceding the date of the judgment."

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[10] RBC sought $ 6,766,992.50 for consequential damages. They claimed lost profits of $ 6,643.968.75 from business with Fidelity, and $ 123,023.75 from business with Highland. (Defs.' Reply at 3.)

The parties agree that post-judgment interest should begin to run from March 11, 2008, which was the date of entry of judgment. (Highland's Amend. Reply at 4; Defs.' Amend. Opp. at 13-14.) Plaintiffs assert, and defendants do not dispute, that the applicable post-judgment interest rate should be 1.66%. (McNamara Aff. Ex. 11 (Federal Reserve Statistical Release, H.15(519) Selected Interest Rates (Mar. 10, 2006)).) Accordingly, the Judgment shall be amended to indicate that the post-judgment interest shall run from March 11, 2008 at a rate of 1.66%.

CONCLUSION

For the reasons set forth above, defendants' motion for judgment as a matter of law, or in the alternative, for a new trial is hereby DENIED. Plaintiffs' joint motion to correct the judgment is hereby GRANTED, and defendants' motion to alter or amend the judgment is hereby DENIED.

SO ORDERED.

New York, New York August 20, 2008

/s/ Peter K. Leisure U.S.D.J.

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

At a stated term of the United States Court of Appeals for the Second Circuit, held at the Daniel Patrick Moynihan United States Courthouse, 500 Pearl Street, in the City of New York, on the 29th day of July, two thousand ten.

Highland Capital
Management LP,

Plaintiff-Appellee,

RBC Dominion
Securities Corp.,

Third-Party-Defendant-Counter-Claimant-Appellee,

v.

Leonard Schneider,
Leslie Schneider,
Scott Schneider,
Susan Schneider,

Defendants-Third-Party-Plaintiffs-Counter-Defendants-Appellants,

Jenkins & Gilchrist
Parker Chapin LLP,

Defendant.

Docket No. 08-4630-cv

(Filed Jul. 29, 2010)

Highland Capital Management LP having filed a petition for panel rehearing, or, in the alternative, for

rehearing *en banc*, and the panel that determined the appeal having considered the request for panel rehearing, and the active members of the Court having considered the request for rehearing *en banc*,

IT IS HEREBY ORDERED that the petition is denied.

FOR THE COURT:
Catherine O'Hagan Wolfe, Clerk

[SEAL]

/s/ Catherine O'Hagan Wolfe

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

At a stated term of the United States Court of Appeals for the Second Circuit, held at the Daniel Patrick Moynihan United States Courthouse, 500 Pearl Street, in the City of New York, on the 23rd day of August, two thousand ten.

Highland Capital
Management LP,

Plaintiff-Appellee,

RBC Dominion
Securities Corp.,

Third-Party-Defendant-Counter-Claimant-Appellee,

Docket No. 08-4630-cv

(Filed Aug. 23, 2010)

v.

Leonard Schneider,
Leslie Schneider,
Scott Schneider,
Susan Schneider,

Defendants-Third-Party-Plaintiffs-Counter-Defendants-Appellants,

Jenkins & Gilchrist
Parker Chapin LLP,

Defendant.

RBC Dominion Securities Corp. having filed a petition for panel rehearing, or, in the alternative, for

rehearing *en banc*, and the panel that determined the appeal having considered the request for panel rehearing, and the active members of the Court having considered the request for rehearing *en banc*,

IT IS HEREBY ORDERED that the petition is denied.

FOR THE COURT:
Catherine O'Hagan Wolfe, Clerk

[SEAL]

/s/ Catherine O'Hagan Wolfe

Highland Capital Management LP,
Appellant-Respondent,
v
Leonard Schneider et al.,
Defendants and Third-Party Plaintiffs-Respondents-Appellants, et al., Respondent.
RBC Dominion Securities Corp.,
Third-Party Defendant-Respondents-Appellant.

No. 172

COURT OF APPEALS OF NEW YORK

2006 NY Slip. Op. 6482; 7 N.Y.3d 836; 857 N.E.2d 527; 824 N.Y.S.2d 206, 2006 N.Y. LEXIS 2619

September 8, 2006, Submitted
September 19, 2006, Decided

PRIOR HISTORY:

Highland Capital Mgmt., LP v. Schneider, 460 F.3d 308, 2006 U.S. App. LEXIS 20993 (2d Cir. N.Y., 2006)

JUDGES: Chief Judge Kaye and Judges G.B. Smith, Ciparick, Rosenblatt, Graffeo, Read and R.S. Smith concur.

OPINION

Certification of question by the United States Court of Appeals for the Second Circuit, pursuant to section 500.27 of the Rules of Practice of the Court of Appeals (22 NYCRR 500.27), accepted and the issues presented are to be considered after briefing and argument.

Concur: Chief Judge Kaye and Judges G.B. Smith, Ciparick, Rosenblatt, Graffeo, Read and R.S. Smith concur.

Decided September 19, 2006

Highland Capital Management LP, Appellant-Respondent,

v

Leonard Schneider et al., Respondents-Appellants and Third-Party-Plaintiffs, and Jenkens & Gilchrist Parker Chapin LLP, Respondent.

RBC Dominion Securities Corp., Third-Party Defendant-Respondent.

No. 38

COURT OF APPEALS OF NEW YORK

2007 NY Slip. Op. 2791; 8 N.Y.3d 406; 866 N.E.2d 1020; 834 N.Y.S.2d 692; 2007 N.Y. LEXIS 613; 62 U.C.C. Rep. Serv. 2d (Callaghan) 491

February 14, 2007, Argued
April 3, 2007, Decided

PRIOR HISTORY:

Proceeding, pursuant to NY Constitution, article VI, § 3(b)(9) and Rules of the Court of Appeals (22 NYCRR) § 500.27, to review a question certified to the New York State Court of Appeals by the United States Court of Appeals for the Second Circuit. The following question was certified by the United States Court of Appeals and accepted by the New York State Court of Appeals: "Based on this record, do the eight promissory notes issued by McNaughton Apparel Group, Inc., to the Schneiders fall within the definition of a 'security' as contemplated by section 8-102[(a)](15) of the New York Uniform Commercial Code?"

Highland Capital Mgmt., LP v. Schneider, 460 F.3d 308, 2006 U.S. App. LEXIS 20993 (2d Cir. N.Y., 2006)

DISPOSITION: Following certification of a question by the United States Court of Appeals for the Second Circuit and acceptance of the question by this Court pursuant to section 500.27 of the Rules of Practice of the New York State Court of Appeals, and after hearing argument by counsel for the parties and consideration of the briefs and the record submitted, certified question answered in the affirmative.

HEADNOTES

Bills, Notes and Checks – Promissory Note – Subordinated Promissory Notes as "Securities" under U.C.C. Article 8

The subordinated promissory notes at issue constituted securities within the meaning of U.C.C. 8-102(a)(15). Pursuant to the statute, a security is an obligation of the issuer that is transferable, divisible and dealt in or traded on securities exchanges. The notes satisfied the transferability test as obligations "represented by a security certificate in . . . registered form" (U.C.C. 8-102[a][15][i]) inasmuch as they were papers that definitively embodied and evidenced the underlying intangible obligation of the issuer to defendant shareholders (U.C.C. 8-102[a][4], [16]). They were in "registered form" (U.C.C. 8-102[a][13]) since each of the notes specified one of the four defendant shareholders as the "person entitled to the security" (U.C.C. 8-102[a][13][i]), and the notes could have been registered on transfer books maintained by the issuer

(U.C.C. 8-102[a][13][ii]). The notes, which were divided into two groups of four notes each and were identified as a class of obligations, satisfied the divisibility test in U.C.C. 8-102(a)(15)(ii), which requires that there be at least two instruments in a specified class or series, or that the single instrument be divisible into at least one additional instrument. Further, the notes fulfilled the functional test in U.C.C. 8-102(a)(15)(iii)(A) because the obligations "[were], or [were] of the type, dealt in or traded on securities exchanges or securities markets." Finally, the determination that these subordinated promissory notes were article 8 securities was consistent with existing case law.

COUNSEL: *Troutman Sanders LLP*, New York City (*Katherine C. Ash* and *Alvin M. Stein* of counsel), for respondents-appellants. I. The Schneiders' notes are not "securities" and any alleged oral agreement for their sale is covered by the statute of frauds at U.C.C. 1-206(1). (*Federal Deposit Ins. Corp. v. Herald Sq. Fabrics Corp.*, 81 A.D.2d 168, 439 N.Y.S.2d 944; *Parma Tile Mosaic & Marble Co. v. Estate of Short*, 87 N.Y.2d 524, 640 N.Y.S.2d 477, 663 N.E.2d 633; *Morris Cohon & Co. v. Russell*, 23 N.Y.2d 569, 245 N.E.2d 712, 297 N.Y.S.2d 947; *State of New York v. Patricia II.*, 6 N.Y.3d 160, 844 N.E.2d 743, 811 N.Y.S.2d 289; *Van Amerogen v. Donnini*, 78 N.Y.2d 880, 577 N.E.2d 1035, 573 N.Y.S.2d 443; *Vigilant Ins. Co. of Am. v. Housing Auth. of City of El Paso, Tex.*, 87 N.Y.2d 36, 660 N.E.2d 1121, 637 N.Y.S.2d 342; *Graham v. Commissioner of Internal Revenue*, 304 F.2d 707; *Gerard v. Helvering*, 120 F.2d 235; *Rangolan v. County of Nassau*, 96 N.Y.2d 42, 749 N.E.2d 178, 725 N.Y.S.2d 611; *Abood v. Hospital Ambulance*

Serv., 30 N.Y.2d 295, 283 N.E.2d 754, 332 N.Y.S.2d 877.) II. The legislative history belies the contention that the securities industry is to be unburdened from compliance with the statute of frauds. III. Highland Capital Management LP proffers no valid grounds for excluding the Schneiders' notes from the application of U.C.C. 1-206(1). (*ALH Props. Ten v. 306-100th St. Owners Corp.*, 191 A.D.2d 1, 240 N.Y.S.2d 417, 86 N.Y.2d 643, 635 N.Y.S.2d 161, 658 N.E.2d 1034; *Horn & Hardart Co. v. Pillsbury Co.*, 703 F. Supp. 1062, 888 F.2d 8; *Corporacion Venezolana de Fomento v. Vintero Sales Corp.*, 452 F. Supp. 1108, 607 F.2d 994; *Cohn, Ivers & Co. v. Gross*, 56 Misc. 2d 491, 289 N.Y.S.2d 301; *Allegaert v. Chemical Bank*, 657 F.2d 495; *Dairyland Fin. Corp. v. Federal Intermediate Credit Bank of St. Paul*, 852 F.2d 242; *Lazard Freres & Co. v. Protective Life Ins. Co.*, 108 F.3d 1531, 522 U.S. 864, 118 S. Ct. 169, 139 L. Ed. 2d 112; *Matter of Waldstein*, 160 Misc. 763, 291 N.Y.S. 697; *Baker v. Gotz*, 387 F. Supp. 1381.)

Lackey Hershman, L.L.P. (*Paul B. Lackey* and *Jamie R. Welton* of the Texas bar, admitted pro hac vice, of counsel), for appellant-respondent. I. U.C.C. 8-102(a)(15) should be construed liberally to encompass the notes. (*ALH Props. Ten v. 306-100th St. Owners Corp.*, 191 A.D.2d 1, 600 N.Y.S.2d 443.) II. The notes are transferable. III. The notes are divisible. (*Allegaert v. Chemical Bank*, 657 F.2d 495; *Baker v. Gotz*, 387 F. Supp. 1381.) IV. The notes are considered "securities" by the market. (*Allegaert v. Chemical Bank*, 657 F.2d 495; *Vigilant Ins. Co. of Am. v. Housing Auth. of City of El Paso, Tex.*, 87 N.Y.2d 36, 660 N.E.2d 1121, 637 N.Y.S.2d 342; *ALH Props. Ten v. 306-100th St. Owners Corp.*,

191 A.D.2d 1, 600 N.Y.S.2d 443; *Matter of Waldstein*, 160 Misc. 763, 291 N.Y.S. 697; *Lazard Freres & Co. v. Protective Life Ins. Co.*, 108 F.3d 1531; *Morris Cohon & Co. v. Russell*, 23 N.Y.2d 569, 245 N.E.2d 712, 297 N.Y.S.2d 947.)

JUDGES: Opinion by Judge Read. Chief Judge Kaye and Judges Ciparick, Graffeo and Jones concur. Judge Smith dissents and votes to answer the certified question in the negative in an opinion in which Judge Pigott concurs.

OPINION BY: Read, J.

OPINION

Read, J.

The United States Court of Appeals for the Second Circuit has asked us whether the eight promissory notes at issue in this case are "securities" within the meaning of section 8-102(a)(15) *of the Uniform Commercial Code*. For the reasons that follow, we conclude that they are.

I.

In April 1998, Norton McNaughton, Inc. (subsequently, McNaughton Apparel Group, Inc.) acquired two women's apparel companies-Jeri-Jo Knitwear Inc. (owned by Leonard Schneider), and Jamie Scott, Inc. (owned by his three children, Leslie, Susan and Scott Schneider). These two businesses were combined to form a division of McNaughton called Jeri-Jo Knitwear, Inc. (Jeri-Jo). Under the terms of the

Agreement of Purchase and Sale, McNaughton paid the Schneiders $55 million in cash, assumed $10.9 million in debt, and agreed to a future earn-out payment based on Jeri-Jo's performance over the two-year period ending in June 2000, during which the Schneider children managed this business for McNaughton.[1]

The earn-out payment was fixed at $190 million, which the Agreement called for McNaughton to pay to the Schneiders in cash or, at McNaughton's option, up to 50% in common stock. In light of available cash flow, however, McNaughton was only able to make the minimum cash payment, and wished to avoid the significant dilutive effect on earnings of paying the balance in stock. As an alternative, McNaughton proposed issuing the Schneiders a three-year note secured solely by the face value of the stock to which they were entitled. Ultimately, McNaughton and the Schneiders compromised, agreeing to retire the earn-out obligation as of August 29, 2000 for $161 million, consisting of $125 million in cash ($95 million to be paid immediately and $30 million to be paid on or before November 30, 2000, subject to financing); two million shares of common stock at $13 per share ($26 million); and four three-year subordinated promissory

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[1] Earn-out provisions in merger-and-acquisition agreements are intended to accommodate the seller's desire for compensation for the anticipated future value of the transferred assets and the buyer's reciprocal desire to avoid overpaying for potential, but as yet unrealized, value. In this case, the earn-out was based on Jeri-Jo's profitability, not its sales.

notes with a combined face value of $10 million. They also agreed that if financing could not be arranged for the $30 million cash payment, McNaughton would pay the Schneiders $59 million in a combination of cash, unsecured subordinated notes and/or shares of common stock at McNaughton's option.

In October 2000, McNaughton's chief executive officer informed the Schneiders that, given McNaughton's stock price, the company was unlikely to raise the additional equity needed to fund the $30 million payment fast coming due. He asked the Schneiders to extend the November 30th deadline to April 30, 2001. In the end, the Schneiders declined this request and, on December 10, 2000, four three-year subordinated promissory notes with an overall face value of $59 million were issued to them in lieu of the $30 million cash payment.

The eight notes with an aggregate face value of $69 million (the four issued in August 2000 plus the four issued the following December), running 12 pages apiece, were each payable to one or another of the four Schneiders.[2] The notes required McNaughton

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[2] Specifically, the subordinated promissory notes issued and dated August 29, 2000 were payable to Leonard Schneider in the amount of $4 million; Leslie Schneider in the amount of $2.4 million; Scott Schneider in the amount of $1.2 million; and Susan Schneider in the amount of $2.4 million. The subordinated promissory notes issued December 10, 2000 and dated December 1, 2000 were payable to Leonard Schneider in the amount of $23.6 million; Leslie Schneider in the amount of

(Continued on following page)

to make quarterly principal and monthly interest payments to the named payee. McNaughton was designated the maker of the notes, each of which bore the following restrictive legend: "THIS NOTE HAS NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED. IT MAY NOT BE TRANSFERRED IN THE ABSENCE OF AN EFFECTIVE REGISTRATION STATEMENT UNDER SUCH ACT OR AN OPINION OF COUNSEL TO THE MAKER THAT SUCH REGISTRATION IS NOT REQUIRED." Each note was marked "SUBORDINATED PROMISSORY NOTE" on its face because these notes were subordinate to McNaughton's existing bank and bond debt amounting to roughly $350 million. Upon McNaughton's default, the payee had the right to declare the entire amount under the note due and owing, and to elect either to receive payment in stock or to accelerate payment. The notes stated that they were "governed by and construed in accordance with" New York law.

The securities industry professionals who subsequently dealt with the notes considered them to be high-risk debt akin to junk bonds. Consequently, it was anticipated that any potential purchaser would expect a high yield or internal rate of return. Concomitantly, the notes carried a substantial, variable interest rate (initially, 9.34% on the December notes).

$14.16 million; Scott Schneider in the amount of $7.08 million; and Susan Schneider in the amount of $14.16 million.

As it turned out, McNaughton was acquired in June 2001 by Jones Apparel Group, Inc. As a result of the merger (an "Event of Default" under the terms of the notes), Jones redeemed the notes at par value, paying the Schneiders $69 million plus interest through June 19, 2001. The parties to this litigation dispute whether the Schneiders reneged on an oral agreement to sell seven of the eight notes when they learned of the planned acquisition before it was announced to the public. In particular, Highland Capital Management LP alleges that the Schneiders, through their agent and broker, Glen Rauch of Glen Rauch Securities, Inc., retained RBC Dominion Securities Corporation (now RBC Capital Markets Corporation) to market the notes on their behalf, and that on March 14, 2001, RBC purchased the notes from the Schneiders for 51 cents on the dollar, and then immediately resold seven of the eight notes to Highland for 52.5 cents on the dollar.[3]

On October 18, 2001, Highland brought this suit against the Schneiders in Texas state court. The action was removed to federal court in Texas on diversity grounds, and then transferred to the United States District Court for the Southern District of New York. As relevant here, the complaint alleges that the Schneiders breached an oral agreement to sell the notes to Highland or, alternatively, breached

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[3] Highland alleges that RBC resold the remaining note to Fidelity Management and Research Company, also on March 14, 2001 and for 52.5 cents on the dollar.

a binding preliminary agreement to do so, or breached an agreement to sell the notes to RBC, of which Highland was a third-party beneficiary.[4] The Schneiders answered, denying they had ever agreed to sell the notes to anyone on March 14, 2001 at any price, and asserting that any such oral agreement would have been unenforceable anyway since it fell within the statute of frauds. After the close of discovery, the Schneiders moved for summary judgment to dismiss the complaint.

The Uniform Commercial Code generally bars enforcement of purported agreements to sell personal property in excess of $5,000 unless "there is some writing which indicates that a contract for sale has been made between the parties at a defined or stated price, reasonably identifies the subject matter, and is signed by the party against whom enforcement is sought or by his authorized agent" (U.C.C. 1-206[1]). In considering the Schneiders' statute-of-frauds defense, the District Judge observed that the statute does not apply to a contract for the sale or purchase of a "security" (U.C.C. 8-113) (*Highland Capital Mgt., L.P. v. Schneider,* 2005 WL 1765711, *13, 2005 U.S. Dist. LEXIS 14912, *43 [S.D.N.Y., July 26, 2005], quoting

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[4] RBC intended to act as a "riskless principal." That is, RBC sought to eliminate its risk for variable market conditions by obtaining commitments to a specified price from both the seller (here, 51 cents on the dollar) and the ultimate buyer (here, 52.5 cents on the dollar from two buyers) before executing a trade with the seller. RBC's compensation on the transaction would have been the spread between these two prices.

Wharf [Holdings] Ltd. v. United Int'l Holdings, Inc., 532 U.S. 588, 595, 121 S. Ct. 1776, 149 L. Ed. 2d 845 [2001] ["Oral contracts for the sale of securities are sufficiently common that the Uniform Commercial Code and statutes of frauds in every State now consider them enforceable"]). He concluded, however, that the seven promissory notes were not securities for purposes of article 8 of the Uniform Commercial Code, because they were not transferrable within the meaning of section 8-102(a)(15)(i).

The District Judge dismissed Highland's two breach-of-contract claims against the Schneiders on the merits. Although he found an issue of material fact with respect to Highland's claim to be a third-party beneficiary of a contract between the Schneiders and RBC, the District Judge dismissed this cause of action for lack of subject matter jurisdiction. He reasoned that since the underlying oral agreement, even if proven, would only be enforceable up to $5,000 because of the statute of frauds, the claim fell short of the $75,000 statutory threshold for diversity jurisdiction. Highland appealed.

"Given the dearth of caselaw on what constitutes a security under the New York version of [article 8] of the New York U.C.C., and the manifest significance of the determination," the Second Circuit retained jurisdiction over Highland's three contract-based claims, and certified the following question to us: "Based on this record, do the eight promissory notes issued by McNaughton Apparel Group, Inc. to the Schneiders fall within the definition of a security as

contemplated by section 8-102[(a)](15) of the New York Uniform Commercial Code?" (*Highland Capital Mgt., LP v. Schneider*, 460 F.3d 308, 322 [2d Cir. 2006] [internal quotation marks omitted]). We answer that question in the affirmative.

II.

The Uniform Commercial Code defines "security" at section 8-102(a)(15) as

> "an obligation of an issuer or a share, participation, or other interest in an issuer or in property or an enterprise of an issuer:
>
> "(i) which is represented by a security certificate in bearer or registered form, or the transfer of which may be registered upon books maintained for that purpose by or on behalf of the issuer;
>
> "(ii) which is one of a class or series or by its terms is divisible into a class or series of shares, participations, interests, or obligations; and
>
> "(iii) which:
>
> "(A) is, or is of a type, dealt in or traded on securities exchanges or securities markets; or
>
> "(B) is a medium for investment and by its terms expressly provides that it is a security governed by this Article."

Thus, the promissory notes must fulfill the requirements of subparagraphs (i) (the transferability test), (ii) (the divisibility test) and (iii) (the functional test) of section 8-102(a)(15) in order to qualify as a security for purposes of article 8 (*see generally* U.C.C. 8-102, Comment 15; 7A Hawkland and Rogers U.C.C. Series § 8-102:01 [rev art 8]; *see also,* Report on Proposed Revisions to Article 8 to Assn of Bar of City of NY as prepared by Comms on Uniform State Laws and Banking Law, Bill Jacket, L 1997, ch 566, at 65 [" 'Security' as defined in Revised Section 8-102(a)(15) . . . includes . . . any other obligation of the issuer . . . that is transferable, divisible, and is dealt in or traded on securities exchanges"]).

First, we must consider whether the notes are obligations "represented by a security certificate in bearer or registered form." Section 8-102(a)(4) defines a "certificated security" as "a security that is represented by a certificate," and section 8-102(a)(16) defines a "security certificate" as "a certificate representing a security." These definitions are, as the Second Circuit observed, somewhat circular, and might refer either to a specialized document like a traditional stock certificate or, more generally, to a paper embodying the underlying intangible interest. Of course, the definitions in section 8-102 were deliberately worded by the drafters "in *general terms,* because they must be sufficiently *comprehensive and flexible* to cover the wide variety of investment products that now exist or may develop" (U.C.C. 8-103, Comment 1 [emphasis added]). We see no reason to

accept the Schneiders' invitation to read "certificated security" and "security certificate" more narrowly than their plain words suggest. Thus, we interpret these terms to encompass the eight subordinated promissory notes, which are papers that definitively embody and evidence the underlying intangible obligation of McNaughton to the Schneiders.

The notes are obviously not in bearer form; therefore, our next inquiry is whether they are in "registered form." In this regard, section 8-102(a)(13) states that

> "'[r]egistered form', as applied to a certificated security, means a form in which:
>
> "(i) the security certificate specifies a person entitled to the security; and
>
> "(ii) a transfer of the security may be registered upon books maintained for that purpose by or on behalf of the issuer, or the security certificate so states."

Each of the notes specifies one of the four Schneiders as the "person entitled to the security," which satisfies section 8-102(a)(13)(i). Accordingly, we must next look at whether "a transfer of the security *may be* registered upon books maintained for that purpose by or on behalf of the issuer," as required by section 8-102(a)(13)(ii) (emphasis added). The Schneiders (and the dissent) argue that in order to fulfill this requirement, McNaughton must have set up or kept separate and independent transfer books for this purpose at the time it issued the notes.

We agree with the Second Circuit, however, "that the proper inquiry is whether the notes *could have been* registered on transfer books maintained by McNaughton, not whether they were registered on transfer books at the time of the litigation" (460 F.3d at 314 [discussing identical language in section 8-102(a)(15)(i)]).

In this regard, the rules in part 4 of article 8 are instructive. Part 4, along with parts 2 and 3, deals with the rights of persons who hold certificates directly, as the Schneiders did here. Section 8-401 sets out the preconditions that trigger the issuer's duty to register a certificated security when it is presented with a request to register a transfer.[5] Thus, the phrase "may be registered" in section 8-102(a)(13)(ii) refers to whether McNaughton would have been required to register the transfer of the notes to a third party at the Schneiders' request.

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[5] These preconditions for certificated securities include whether, under the security's terms, the person seeking registration of transfer is eligible to have the security registered in his name; the indorsement is made by the appropriate person or an agent with actual authority; reasonable assurance is given that the indorsement is genuine and authorized; applicable tax laws have been complied with; the transfer does not violate any restriction on transfer imposed by the issuer against a person with actual knowledge, or constructive knowledge (i.e., any restriction is conspicuously noted on the certificate); there is not in force an effective demand by a registered owner that the issuer not register a transfer; and the transfer is in fact rightful or is to a protected purchaser (*see* U.C.C. 8-401).

We conclude that McNaughton ultimately would have been constrained to do so. McNaughton did not restrict transfer of the notes other than by the legend, as its chief executive officer acknowledged. And the restrictive legend itself suggests that the parties contemplated the possibility of future transfer. As Highland points out, as a practical matter, McNaughton would have to have recorded any transfer of the notes in order to protect itself and the senior debt holders. For example, in the event of default, the payee of the notes could have elected conversion of the principal to common stock, thus diluting other shareholders' value; and because the notes called for hefty payments of principal and interest, McNaughton had to have a way to keep track of the proper payees. Accordingly, we conclude that the notes satisfy the transferability test in U.C.C. 8-102(a)(15)(i): they were obligations represented by a security certificate in registered form.[6]

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[6] We note that we are not "[c]onfusing registrability upon transfer books with recording in corporate books generally," as the dissent contends (dissenting op. at 420). Rather, we conclude, for the reasons stated, that "the notes *could have been* registered on transfer books maintained by McNaughton" (460 F.3d at 314). The dissent also acknowledges that McNaughton had (or must have had) transfer books (presumably, to register transfer of the 12 1/2% senior notes), but asserts that "those books were not available for registering transfers of the notes at issue here" (dissenting op. at 419). Even if correct, this pronouncement begs the question of whether, in light of section 8-401, McNaughton would have been required to register transfer

(Continued on following page)

Further, the notes satisfy the divisibility test in section 8-102(a)(15)(ii). "[M]inimum compliance with this formality requires that there be at least two instruments in a specified class or series, or that the single instrument be divisible into at least one additional instrument" (*Allegaert v. Chemical Bank,* 657 F.2d 495, 507 [2d Cir. 1980] [citation and internal quotation marks omitted]; *see also Baker v. Gotz,* 387 F. Supp. 1381, 1390 [D. Del. 1975] [where six notes are issued for a total of 25,360,000 Swiss francs, the notes are "patently one of a class or series"] [citation and internal quotation marks omitted]; U.C.C. 8-102, Comment 15 ["The divisibility test of subparagraph (ii) applies to the security – that is, the underlying intangible interest"]). Here, there were eight notes, divided into two groups of four notes each. The eight notes were identified in McNaughton's Form 8-K as a class of obligations, in the same category, in fact, as McNaughton's 12 1/2% senior notes, which the Schneiders concede were article 8 securities.

Next, the notes fulfill the functional test in section 8-102(a)(15)(iii)(A) because these obligations "[were], or [were] of a type, dealt in or traded on securities exchanges or securities markets." This component "provides flexibility while ensuring that the Article 8 rules do not apply to interests or obligations in circumstances so unconnected with the

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of the subordinated promissory notes if the Schneiders had asked McNaughton to do so.

securities markets that parties are unlikely to have thought of the possibility that Article 8 might apply" (U.C.C. 8-102, Comment 15). Tellingly, the many securities industry professionals from Rauch, RBC and Highland who dealt with the notes uniformly treated them as securities. McNaughton's chief executive officer, when he first proposed issuing the notes in lieu of cash or stock, described them as a "form of a convertible subordinated debenture." When McNaughton issued the notes to the Schneiders in August 2000, it reported its actions to the Securities and Exchange Commission, and put out a press release to inform the public.

Finally, our determination that these subordinated promissory notes are article 8 securities is consistent with existing case law, sparse though it may be (*see e.g. Vigilant Ins. Co. of Am. v. Housing Auth. of City of El Paso, Tex.*, 87 N.Y.2d 36, 43, 660 N.E.2d 1121, 637 N.Y.S.2d 342 [1995] [stating broadly that "article 8 of the Uniform Commercial Code . . . governs stocks, bonds and other evidences of indebtedness"]; *see also Baker, supra* [promissory notes are securities under section 8-102]; *S.N. Phelps & Co. v. Prudential Ins. Co. of Am.*, U.S. Dist. Ct., D. Conn., Nov. 22, 1991, Cabranes, J. [considering senior subordinate notes, essentially indistinguishable from the subordinated promissory notes in this case, to be article 8 securities]). Treating these notes as article 8 securities comports with a central goal of the Uniform Commercial Code, which is to create a framework for commercial activity that reflects and fosters

developing custom and usage. Or as one commentator remarked with specific reference to article 8: "[T]he definition [of securities] will change as 'securities' trading practices evolve to include or exclude new property interests. It is believed that the definition will cover anything which securities markets, including not only the organized exchanges but as well the 'over-the-counter' markets, are likely to regard as suitable for trading" (8 Lawrence's Anderson on the Uniform Commercial Code § 8-102:1, at 29 [3d ed rev 2005]; *see also Bentley v. ASM Communications, Inc.*, 1991 WL 105220, at *2, 1991 U.S. Dist. LEXIS 7855, at *5-6 [S.D.N.Y., June 11, 1991] [citing pre-1997 Comment 2 to section 8-102 to support defining the term "security" broadly]).

Accordingly, the certified question should be answered in the affirmative.

DISSENT BY: SMITH, J.

DISSENT

Smith, J. (dissenting). The question of when a promissory note is a "security" is a familiar one in federal securities law, and has proved very difficult (*see e.g. Reves v. Ernst & Young*, 494 U.S. 56, 110 S. Ct. 945, 108 L. Ed. 2d 47 [1990]; *Chemical Bank v. Arthur Andersen & Co.*, 726 F.2d 930 [2d Cir. 1984]; *Exchange Natl. Bank of Chicago v. Touche Ross & Co.*, 544 F.2d 1126 [2d Cir. 1976]). The authors of the Uniform Commercial Code made the question of what

is a "security" for U.C.C. purposes easier, by including in the definition of "security" an element not present in federal securities law: with some exceptions, an obligation is not a security for U.C.C. purposes unless it "may be registered upon books maintained for that purpose by or on behalf of the issuer" (U.C.C. 8-102[a][15][i]). Today, the majority effectively undoes the work of the U.C.C.'s authors, by reading this registrability requirement in so broad a way as to make it meaningless.

Though it is not apparent from the majority opinion, registrability is the only significant issue in this case. No one disputes that what the majority calls the "divisibility test" and the "functional test" in the U.C.C. definition of "security" (U.C.C. 8-102[a][15][ii], [iii]) are met here. The majority holds that the notes at issue are "represented by . . . securit[ies] certificate[s]" within the meaning of U.C.C. 8-102(a)(15)(i), but it does not matter whether the majority is right or wrong about this, because registrability is necessary to make either an uncertificated obligation or a non-bearer certificated obligation into a security. If the obligation is certificated, the certificate must be in either "bearer or registered form" (*id.*), and the definition of "registered form" requires that "a transfer of the security may be registered upon books maintained for that purpose by or on behalf of the issuer, or the security certificate so states" (U.C.C. 8-102[a][13][ii]). If the obligation is not certificated, it is still a security if it meets the other tests and its "transfer . . . may be registered upon books

maintained for that purpose by or on behalf of the issuer" (U.C.C. 8-102[a][15][i]). Registrability is therefore critical, whether there is a certificate or not.

Before considering the meaning of the registrability requirement, it is useful to consider why the U.C.C.'s authors made it part of their definition of "security" – a definition that is completely independent of the federal securities law definition of the same term (*see* U.C.C. 8-102, Comment 3 [1977 amendments], reprinted in, 8 Lawrence's Anderson on the Uniform Commercial Code § 8:102:1, at 29-30 [3d ed rev 2005]). The apparent reason for the requirement is to facilitate line-drawing – to provide a relatively simple test to distinguish between obligations and interests that are securities and those that are not. As the Comment says: "The definition of 'registered form'. . . . [s]erves primarily to distinguish Article 8 securities from instruments governed by other law, such as Article 3" (U.C.C. 8-102, Comment 13).

These distinctions matter. For example, the rights and obligations of an issuer and holder of an article 3 negotiable instrument are substantially different from those of an issuer and holder of an article 8 security. The issuer of a security in registered form may treat the registered owner as the owner for all purposes, until the security is presented for registration of transfer (*see* U.C.C. 8-207[a]). The issuer of an unregistered negotiable instrument does not have that option. The indorser of a negotiable instrument may also be liable to subsequent holders in the event that the issuer defaults (*see* U.C.C. 3-414).

The indorser of an article 8 security, in contrast, makes no warranties with respect to the issuer's ability to satisfy the underlying obligation (*see* U.C.C. 8-108).

The need for clear distinctions led the authors of the U.C.C. to adopt the formalistic requirement of registrability. Such formalism would be out of place in the federal securities laws, which have the prevention of fraud and other abuses in securities markets among their primary purposes. Congress wanted to make evasion of the federal securities laws difficult, and accordingly:

> "[i]n defining the scope of the market that it wished to regulate, Congress painted with a broad brush. It recognized the virtually limitless scope of human ingenuity, especially in the creation of 'countless and variable schemes devised by those who seek the use of the money of others on the promise of profits,' *SEC v. W. J. Howey Co.*, 328 U.S. 293, 299 66 S. Ct. 1100, 1103, 90 L. Ed. 1244 (1946), and determined that the best way to achieve its goal of protecting investors was 'to define "the term 'security' in sufficiently broad and general terms so as to include within that definition the many types of instruments that in our commercial world fall within the ordinary concept of a security.'" [*United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 847-848, 95 S. Ct. 2051, 44 L. Ed. 2d 621 (1975)] (quoting H. R. Rep. No. 85, 73d Cong., 1st Sess., 11 (1933)). Congress therefore did not attempt precisely to cabin

> the scope of the Securities Acts. Rather, it enacted a definition of 'security' sufficiently broad to encompass virtually any instrument that might be sold as an investment"

(*Reves*, 494 U.S. at 60-61).

The U.C.C. is less concerned with frustrating the ingenuity of schemers, and more with providing a workable and predictable code to govern legitimate transactions. The purposes of the U.C.C. are therefore well served by making the line between securities and other interests and obligations as clear as possible – a clarity that is lacking in federal securities law. The "broad brush" approach of the federal securities laws prompts participants in transactions to err on the side of caution, and to assume – as the parties in this case did – that anything near the borderline is a "security" for federal purposes. But the goal of the U.C.C. is to mark the border plainly.

Registrability is a test well suited to that goal. It has long been a common practice for issuers of stocks, bonds, notes and other obligations or interests to maintain (or to retain a transfer agent to maintain) books on which the transfers of these obligations and interests may be registered. It is not hard to determine whether such books exist or not. If they do, then "transfer [of the obligation or interest] may be registered upon books maintained for that purpose by or on behalf of the issuer" and the registrability requirement is met.

In this case, no claim is made that McNaughton, the issuer of the notes in suit, maintained (itself or through an agent) transfer books on which transfers of these notes could be registered. McNaughton did have transfer books, and transfers were registered on them – including transfers of certain classes of promissory notes – but those books were not available for registering transfers of the notes at issue here. That should end the inquiry: the registrability requirement is not met, and these notes are not securities.

The majority's contrary conclusion rests in part on circular reasoning. It finds that these notes "may be" registered because U.C.C. 8-401 would require registration – but that section applies only to "a certificated security in registered form." Whether the notes are such securities is the very question the majority is deciding.

The majority also seeks to justify its result by overemphasizing some words in the statutes describing the registrability requirement and ignoring others. It emphasizes the words "may be" (majority op. at 413-414), which the majority seemingly takes to mean that the notes are registrable if any books could possibly exist in which transfers of the notes could be registered. Read so broadly, the words "may be" deprive the registrability requirement of any meaning – it is always theoretically possible there could be books on which transfers of anything could be registered. The words "may be registered upon books maintained for that purpose" are much more plausibly read to mean that "books maintained for that

purpose" must exist, on which transfers may (or may not) be registered. In other words, the requirement is met whether transfers are actually registered on the books or not, but not if there are no books "maintained for that purpose" on which registration could occur.

The majority ignores the statutory words "maintained for that purpose." It concludes that the registrability requirement is met because, if the notes are transferred and McNaughton is informed of the transfer, it must obviously record the information somewhere, so that it will have "a way to keep track of the proper payees" (majority op. at 414). On this reading of the statute, it is hard to imagine any transferable obligation of any issuer that would not be registrable. The right question is not whether transfers may be reflected in some way in McNaughton's books and records – of course they may – but whether they "may be registered *upon books maintained for that purpose.*"

Confusing registrability upon transfer books with recording in corporate books generally was essentially the error criticized, in another context, by a distinguished panel of the Second Circuit Court of Appeals in *Gerard v. Helvering* (120 F.2d 235 [2d Cir. 1941, per curiam: L. Hand, Chase and Frank, JJ.]). The issue there was whether payments on a certain bond were a "retirement" of "capital assets" for federal income tax purposes, a question that in turn depended on the registrability of the bond. The court said:

> "[the taxpayer] cannot succeed unless [the bond] was 'in registered form,' a phrase whose meaning in this context is entirely plain. It refers to the common practice in the issuance of corporate bonds which allows the holder of one or more coupon bonds of a series the option to surrender them and have one bond 'registered' upon the books of the obligor or of a transfer agent; or the holder may subscribe for such a bond in the first place. The purpose is to protect the holder by making invalid unregistered transfers, and the bond always so provides upon its face. *The mere fact that the debtor keeps books of account upon which the debt appears is altogether immaterial;* to construe the statute as the taxpayer asks would in effect make the payment of any corporate debt – 'evidence of indebtedness' – a 'retirement' of 'capital assets,' for almost all corporations keep books. It is scarcely necessary to labor the answer to so plain a misinterpretation" (120 F.2d at 235-236 [emphasis added]).

I find the majority's error in interpreting the U.C.C. here to be equally plain.

Chief Judge Kaye and Judges Ciparick, Graffeo and Jones concur with Judge Read; Judge Smith dissents and votes to answer the certified question in the negative in a separate opinion in which Judge Pigott concurs.

Following certification of a question by the United States Court of Appeals for the Second Circuit and acceptance of the question by this Court pursuant to

section 500.27 of the Rules of Practice of the Court of Appeals (22 NYCRR 500.27), and after hearing argument by counsel for the parties and consideration of the briefs and the record submitted, certified question answered in the affirmative.